FILE COPY

TRANSCRIPT OF RECORD

Supreme Court of the United States

OCTOBER TERM, 1960

No. 63

EUGENE C. JAMES, PETITIONER,

vs.

UNITED STATES.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

PETITION FOR CERTIORARI FILED MARCH 26, 1960
CERTIORARI GRANTED MAY 16, 1960

SUPREME COURT OF THE UNITED STATES
OCTOBER TERM, 1960

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RECORD PRESS, PRINTERS, NEW YORK, N. Y., JULY 22, 1960

[Vol. 1]

IN THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

No. 12719

Appeal from the United States District Court for the Northern District of Illinois, Eastern Division.

Honorable J. Sam Perry, District Judge.

UNITED STATES OF AMERICA, Plaintiff-Appellee,

vs.

EUGENE C. JAMES, Defendant-Appellant.

Appellant's Appendix

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS
Eastern Division
No. 57 CR 780

UNITED STATES OF AMERICA, Plaintiff-Appellee,

v.

EUGENE C. JAMES, Defendant-Appellant.

STATEMENT REQUIRED BY RULE 12(c) OF THE RULES OF THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT —June 18, 1959

Now comes the Defendant-Appellant, by his attorneys, and pursuant to Rule 12(c) of the United States Court of Appeals for the Seventh Circuit, states as follows:

[fol. 2] 1. This proceeding was commenced on December 13, 1957, by the return of Indictment No. 57 CR 780.

2. On March 3, 1959, after execution of a Jury Waiver, trial was commenced before the Honorable J. Sam Perry in the United States District Court for the Northern District of Illinois.

3. At the close of the evidence for the Government, the Defendant-Appellant moved the Court for a finding of not guilty, which motion was denied.

4. At the close of all the evidence, the Defendant-Appellant moved the Court for a finding of not guilty, which motion was denied.

5. On May 8, 1959, the Court found the Defendant-Appellant guilty as charged in the Indictment.

6. On May 11, 1959, the Court entered Findings of Fact and Conclusions of Law pursuant to the Defendant's request, which have been made a part of this record on appeal.

7. On May 11, 1959, there was a judgment of conviction of the verdict and the Court sentenced the Defendant to a term of One (1) year on Count I and Two (2) years on Counts II, III, and IV. The sentence on Counts II, III, and IV to run concurrently and consecutive to the sentence on Count I.

8. On May 11, 1959, bail was fixed for the Defendant by the trial court in the amount of Fifteen Thousand ($15,000.00) Dollars.

9. On May 12, 1959, the Defendant-Appellant filed his Notice of Appeal.

Dated at Chicago, Illinois, this 18th day of June, 1959.

Joseph E. Green, Richard E. Gorman, Attorneys for [fol. 3] the Defendant-Appellant, One N. La Salle Street, Chicago 2, Illinois, CEntral 6-7722.

Service of a copy of the foregoing Statement Required by Rule 12(c) of the Rules of the United States Court of Appeals for the Seventh Circuit is acknowledged this 18th day of June, 1959.

R. Ticken, By M. Barnett.

IN UNITED STATES DISTRICT COURT

INDICTMENT

The February 1957 Grand Jury Charges:

That on or about the 19th day of February, 1952, in the Northern District of Illinois, Eastern Division, Eugene C. James, defendant herein, who during the calendar year 1951 was married, did wilfully and knowingly attempt to evade and defeat a large part of the income tax due and owing by him and his wife to the United States of America for the calendar year 1951, by filing and causing to be filed with the Collector of Internal Revenue for the First Internal Revenue Collection District of Illinois, at Chicago, Illinois, a false and fraudulent joint income tax return on behalf of himself and his said wife, wherein it was stated that their joint net income for said calendar year was the sum of $13,375.74 and that the amount of tax due and owing thereon was the sum of $2,353.44; whereas, as he then and there well knew, their joint net income for the said calendar year was the sum of $123,827.09, upon which said net income there was owing to the United States of America an income tax of $70,037.14, in violation of Section 145(b), Internal Revenue Code of 1939; 26 U.S.C. Section 145(b).

[fol. 4]

Count Two

The February 1957 Grand Jury Further Charges:

That on or about the 4th day of March, 1953, in the Northern District of Illinois, Eastern Division, Eugene C. James, defendant herein, who during the calendar year 1952 was married, did wilfully and knowingly attempt to evade and defeat a large part of the income tax due and owing by him and his wife to the United States of America for the calendar year 1952, by filing and causing to be filed with the District Director of Internal Revenue for the Chicago Internal Revenue District at Chicago, Illinois, a false and fraudulent joint income tax return on behalf of himself and his said wife, wherein it was stated that their joint net income for said calendar year was the sum

of $23,203.27 and that the amount of tax due and owing thereon was the sum of $5,997.38; whereas, as he then and there well knew, their joint net income for the said calendar year was the sum of $233,469.00, upon which said net income there was owing to the United States of America an income tax of $166,195.67; in violation of Section 145(b) Internal Revenue Code of 1939; 26 U.S.C. Section 145(b).

Count Three

The February 1957 Grand Jury Further Charges:

That on or about the 12th day of March, 1954, in the Northern District of Illinois, Eastern Division, Eugene C. James, defendant herein, who during the calendar year 1953 was married, did wilfully and knowingly attempt to evade and defeat a large part of the income tax due and owing by him and his wife to the United States of America for the calendar year 1953, by filing and causing to be filed with the District Director of Internal Revenue for the Chicago Internal Revenue District at Chicago, Illinois, a false and fraudulent joint income tax return on behalf of himself and his said wife, wherein it was stated that [fol. 5] their joint net income for said calendar year was the sum of $15,223.15 and that the amount of tax due and owing thereon was the sum of $3,107.88; whereas, as he then and there well knew, their joint net income for the said calendar year was the sum of $407,229.41, upon which said net income there was going to the United States of America an income tax of $325,323.04; in violation of Section 145(b), Internal Revenue Code of 1939; 26 U.S.C. Section 145(b).

Count Four

The February 1957 Grand Jury Further Charges:

That on or about the 15th day of April, 1955, in the Northern District of Illinois, Eastern Division, Eugene C. James, defendant herein, who during the calendar year 1954 was married, did wilfully and knowingly attempt to evade and defeat a large part of the income tax due and owing by him and his wife to the United States of America

for the calendar year 1954, by filing and causing to be filed with the District Director of Internal Revenue for the Chicago Internal Revenue District at Chicago, Illinois, a false and fraudulent joint income tax return on behalf of himself and his said wife, wherein it was stated that their joint net income for said calendar year was the sum of $15,809.58 and that the amount of tax due and owing thereon was the sum of $2,962.88; whereas, as he then and there well knew, their joint net income for the said calendar year was the sum of $45,371.27, upon which said net income there was owing to the United States of America an income tax of $15,847.90; in violation of Section 7201 of the Internal Revenue Code of 1954; 26 U.S.C. Section 7201.

A True Bill: Henry K. Baer, Foreman

R. Tieken, United States Attorney.

[fol. 6]

IN UNITED STATES DISTRICT COURT

ARRAIGNMENT AND PLEA—December 27, 1957

Present: Honorable J. Sam Perry, District Judge

This day comes the United States by the United States Attorney comes also the defendant Eugene C. James in his own proper person and by his counsel and being arraigned upon the indictment filed herein against him pleads not guilty thereto and it is

Ordered that the defendant be and he is hereby given 30 days within which time to file pre-trial motions

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IN UNITED STATES DISTRICT COURT

WAIVER OF TRIAL BY JURY—Filed March 3, 1959

Comes Eugene C. James, defendant in the above entitled cause in his own proper person and by Richard E. Gorman and Joseph E. Green, his attorney, and the defendant, having been advised in open court by the court

of his right to a trial by jury, hereby waives that right and consents to a trial by the court without a jury.

Eugene C. James, Defendant.

Richard E. Gorman, Joseph E. Green, Attorney for Defendant.

[fol. 7] R. Tieken, United States Attorney for the Northern District of Illinois, hereby consents to the waiver by the defendant above-named of a trial by jury of the above-entitled cause.

R. Tieken, United States Attorney, By William A. Barnett, Assistant United States Attorney.

Approved: J. S. Perry, United States District Judge.

In United States District Court

Findings of Fact—May 11, 1959

On December 13, 1957, an Indictment in four counts was returned against defendant charging willful attempted evasion of his income tax and that of his wife for each of the years 1951, 1952, 1953, and 1954, in violation of Section 145(b) of the Internal Revenue Code of 1939 (26 U.S.C. 145(b), and Section 7201 of the Internal Revenue Code of 1954 (26 U.S.C. 7201).

The amounts of the defendant's reported and correct income and tax liability as alleged in the Indictment are as follows:

	Reported		Corrected	
Year	Income	Tax Liability	Income	Tax Liability
1951	$13,375.74	$2,353.44	$123,827.09	$ 70,037.14
1952	23,203.27	5,997.38	233,469.00	136,195.67
1953	15,223.15	3,107.88	407,229.41	325,323.04
1954	15,809.58	2,962.88	45,371.27	15,847.90

[fol. 8] At the opening of trial, defendant, being represented by counsel, executed and filed a waiver of jury in

open court, which waiver was consented to by the Government and approved by the Court. (Tr. 3-4). The case was tried to the Court on March 3, 4, 5 and 6, 1959.

The Court Finds Specially the Following Facts:

1. Defendant filed timely joint income tax returns for himself and his wife for each of the years 1951, 1952, 1953 and 1954 with the District Director of Internal Revenue at Chicago, Illinois. (Tr. 22, 23, 24).

2. The income reported by defendant on his returns consisted of salary received from the Laundry Workers Union, Local No. 46, located in Chicago, Illinois; salary from the Laundry Workers International Union, whose headquarters were in Indianapolis, Indiana; salary from Local No. 985 of the International Brotherhood of Teamsters, located in Detroit, Michigan; certain payments received as a Welfare Deputy for the aforementioned Local No. 46; certain expense monies received from aforementioned Local No. 46. He also reported net losses from the operation of a racing stable. (Exhibits 1 to 4).

3. From January 1, 1950 to August 7, 1952, defendant was seventh Vice President and Acting General Secretary and Treasurer of the Laundry Workers International Union. From August 7, 1952 to December 31, 1954 defendant was General Secretary and Treasurer of the Laundry Workers International Union. In addition, he was Deputy Trustee in charge of Local No. 46 of the Laundry Workers Union from May 13, 1949 until October, 1954, during which period the Local was under a trusteeship. Upon termination of the trusteeship in October, 1954, he became Secretary and Treasurer of the Local. (Tr. 42, 46, 47).

4. Throughout the years 1951 to 1954 inclusive there was [fol. 9] in existence a welfare trust known as the Social Security Department of the Laundry Workers International Union. The trust had been created pursuant to a mandate of the 1949 Convention of the Laundry Workers International Union. The Social Security Department was an entity separate and distinct from the Laundry Workers International Union. The purpose of the trust known as the Social Security Department was to provide welfare

benefits for union members. The Social Security Department was governed by six trustees, three of whom were selected by Management and three by Labor. At no time was the defendant a trustee or other officer of the Social Security Department. (Tr. 42, 43, 44, 60).

5. Defendant was appointed Welfare Deputy for Laundry Workers Local No. 46 of Chicago under a written agreement with the Social Security Department executed on October 9, 1950. (Tr. 64, Exhibit 108). This agreement provided, among other things, that defendant was to receive 5 per cent of all premiums payable to the Security Mutual Life Insurance Company under the latter's contract covering members of Local No. 46, and that expenses incurred by defendant in investigating claims were to be paid by him out of this sum. The agreement between defendant and the Social Security Department contained the following clause:

> * * * Should any surplus remain after payment of said items then it may be retained [by defendant], provided, however, that such surplus shall be reported as income [by defendant] in accordance with law. * * *

In his returns for the years in question, defendant reported as gross income sums allegedly representing the difference between the amounts received and the amounts expended under the agreement. (Tr. 31, 32, 34, 35).

6. The Social Security Department received payments from various employers throughout the country on behalf [fol. 10] of union employees, which payments were deposited by the bookkeeper for the Social Security Department in the Indiana National Bank of Indianapolis, Indiana. The receipt of these funds was regularly recorded by the bookkeeper of the Social Security Department. (Tr. 60, 61, 62).

7. From April 1950 to and including October 1, 1953, the Security Mutual Life Insurance Company of Binghamton, New York, by contract with the Social Security Department of the Laundry Workers International Union, had in effect health and accident insurance policies covering

the members of various laundry workers' locals throughout the country. (Tr. 62, 405, 342). For the period March 1951 to October 1, 1953 premiums on the health and accident policies were paid by the Social Security Department to one Louis B. Saperstein of Newark, New Jersey, an insurance broker and agent for the Security Mutual Life Insurance Company. (Tr. 64, Exhibits 107, 143)

8. Louis B. Saperstein was the Managing Officer of two insurance brokerage firms known as the Harlew Agency of Illinois, Inc., and the Harlew Agency of California, Inc. All checks for payment of premiums to the Security Mutual Life Insurance Company by the Social Security Department were made payable to Louis B. Saperstein and were deposited by him, or persons employed by him, in bank accounts of either Harlew Agency of Illinois, Inc. or Harlew Agency of California, Inc. (Tr. 65, 78).

9. The funds received by Louis Saperstein from the Social Security Department during the years 1951 to 1953 inclusive were wholly disbursed by him for the following purposes:

(a) Payments to the Security Mutual Life Insurance Company of Binghamton, New York, as premiums on the policies in existence between that company and the Social Security Department of the Laundry Workers International Union;

[fol. 11] (b) Payment of claims made by laundry worker employees who, under the terms of the policies, were ineligible to receive benefits from the Security Mutual Life Insurance Company;

(c) By checks drawn to the Order of the Laundry Workers International Union and mailed to the defendant at his residence in Wheaton, Illinois, or at his office in the headquarters of Local No. 46 of the Laundry Workers International Union at 1640 West Van Buren Street, Chicago, Illinois. (Tr. 146, 159, 160).

10. On September 14, 1951, defendant opened a bank account at the Merchants National Bank, Chicago, Illinois,

in the name of the Laundry Workers International Union. (Tr. 48). This bank account was opened without the authorization of the Laundry Workers International Union or the Social Security Department. (Tr. 45, 48). The signature card for this bank account required only the signature of defendant to effect withdrawals from the account. (Tr. 49).

11. Defendant deposited in the above-mentioned Merchants National Bank account all the checks received by him from Saperstein which were payable to the Laundry Workers International Union, and which were drawn on accounts of Harlew Agency of Illinois, Inc. and Harlew Agency of California, Inc. (Exhibits 63 to 81; 109 to 142).

12. The funds so received by defendant and deposited by him in the Merchants National Bank during the years 1951, 1952, 1953 and 1954 amounted to $80,451.35; $175,265.81; $368,367.81; and $29,561.69 respectively (Tr. 427, 428, 429.)

12(a). The funds referred to in paragraphs 11 and 12, supra, were under the laws and statutes of the State of New Jersey embezzled by the defendant, and that under the laws and statutes of such State, the defendant, James, [fol. 12] is guilty of the crime of embezzlement of such funds as a principal, along with Saperstein.

12(b). That Saperstein and the defendant were jointly indicted for the crime of conspiracy to embezzle and for the crime of embezzlement of the funds in question by the Grand Jurors of Essex County, New Jersey, and that such indictment is now pending in the courts of that state; and the defendant has been ordered extradited for trial in New Jersey by order of the Circuit Court of DuPage County, Illinois, which order was affirmed by the Supreme Court of Illinois on March 20, 1959; that there is now pending before the Supreme Court of Illinois a petition for rehearing of the aforesaid order of affirmance.

13. By letters dated July 17, 1951 and July 27, 1951, defendant stated to the Security Mutual Life Insurance Company, that members of the Laundry Workers Inter-

national Union were performing services and incurring expenses in connection with the promotion of the welfare plans, and that in his opinion such functions and expenses were properly the burden of the insurance company. Accordingly, he requested that the insurance company consider reimbursing the union for these expenditures. By letter dated September 10, 1951, addressed to defendant, the insurance company agreed to pay the union $2,500.00 a month as reimbursement for such expenses. The agreement was made retroactive to January, 1951. (Exhibits 171 to 175). Pursuant to this agreement, one check for $20,000.00, covering the retroactive period, was made payable to the Laundry Workers International Union; one check for $2,500.00 was made payable to E. C. James; the remaining monthly checks in the amount of $2,500.00 each were made payable to E. C. James, Acting Secretary-Treasurer of the Laundry Workers International Union. All of these checks were mailed to defendant, endorsed by rubber stamp, and deposited by him in the above-mentioned [fol. 13] account at the Merchants National Bank. For the years 1951, 1952 and 1953 the sums so received and deposited by the defendant totaled $30,000.00, $32,500.00 and $22,500.00 respectively. (Exhibits 144 to 170). The representations made by the defendant to the Security Mutual Life Insurance Company in the aforementioned letters, as a result of which the above sums of $2,500.00 a month were paid by the insurance company, were made without authorization of any other officer of the Laundry Workers International Union or any trustee of the Social Security Department. (Tr. 301).

13(a). That the acts of the defendant referred to in paragraph 13 constituted the crime of embezzlement of the $85,000.00 therein referred to under the laws and statutes of the State of Illinois.

14. On numerous occasions during the years 1951 to 1954 inclusive, defendant visited the Merchants National Bank of Chicago, Illinois, and drew checks on the account maintained by him at this bank in the name of the Laundry Workers International Union. These checks were drawn to the order of E. C. James and were immediately cashed by

him at the bank. (Exhibits 82 to 105; 176 to 192). During the years in question, defendant received from the above sources (i.e., the Harlew Agencies, Inc. and the Security Mutual Life Insurance Company) and deposited in the Merchants National Bank the following sums:

1951	$110,451.35
1952	$207,765.81
1953	390,867.81
1954	29,561.69
Total	$738,646.66

(Tr. 427 to 429)

By May 6, 1954 defendant had withdrawn all funds which he had deposited in this account. (Exhibit 7).

[fol. 14] 15. None of the funds in question were paid over by the defendant to the Laundry Workers International Union or the Social Security Department, and no part of the funds was expended by the defendant for the benefit of the aforementioned union entities. (Tr. 46).

16. During the years involved defendant maintained safe deposit boxes at the Gary-Wheaton Bank in Wheaton, Illinois, the town in which he resided, to which said safe deposit boxes he made frequent entries. During the year 1951 he made nineteen visits to the boxes; during the year 1952 he made twenty-two visits to the boxes; during the year 1953 he made nineteen visits to the boxes; during the year 1954 he made ten visits to the boxes. (Exhibits 432 and 434).

17. Throughout the period in question, defendant also maintained three checking accounts and one savings account at the Gary-Wheaton Bank at Wheaton, Illinois. In addition, he maintained two checking accounts at the Central National Bank in Chicago, Illinois. Defendant made cash deposits to his accounts at the Gary-Wheaton Bank in each of the years 1951, 1952, 1953 and 1954 totaling $27,990.00, $51,860.00, $15,200.00, and $14,310.00 respectively. (Tr. 423 and 424).

In addition to the currency deposits during this time, which exceeded $109,000.00, defendant purchased a horse from Leopha Wilson in November, 1953, for $10,000.00 in currency. (Tr. 253, 254). This currency was not withdrawn from any of defendant's bank accounts. (Tr. 424).

On November 17, 1953 defendant purchased a cashier's check at the Gary-Wheaton Bank in the amount of $2,500.00. There was no withdrawal of a like amount from any of his bank accounts on this date. However, on this same date he made an entry into his safe deposit box at the Gary-Wheaton Bank. (Tr. 276, 277, 436, 437).

[fol. 15] As testified to by Matthew J. Dooley, there was mailed to defendant on December 28, 1953, $27,000.00 worth of stock in the Founders Syndicate of America, Inc., the certificates of which were made out in dummy names and endorsed in blank. This stock resulted from a purchase by Dooley on behalf of a group, including defendant, which group, in the presence of Dooley, had agreed to produce the funds to buy the stock. (Tr. 329, 333, 336, 340, 344, 346, 347).

An analysis of defendant's various bank accounts does not show the withdrawal of $27,000.00 or the withdrawal of any series of checks which would account for the $27,000.00. Defendant's contribution for the purchase of the stock was by cash not withdrawn from his bank accounts. (Exhibits 245, 375, 377, 404, 422, 438, 515).

18. None of the funds withdrawn by defendant from his several accounts at the Gary-Wheaton Bank and the Central National Bank of Chicago during the years 1951 through 1954 were expended on behalf of the Laundry Workers International Union or the Social Security Department, but instead were expended in part for his personal use and benefit. (Tr. 46 and 425).

19. The funds received by the defendant during the years 1951, 1952, 1953 and 1954, which he deposited in the Merchants National Bank of Chicago, Illinois, and subsequently withdrew therefrom, were within his complete dominion and control, and large portions thereof were actually expended by him for his personal benefit. By the receipt of these funds he derived readily realizable eco-

nomic value in the year of receipt. (Tr. 46, 223 to 238, 300 to 301, 429 to 478)

20. Defendant's tax returns for the years in question were prepared on the cash receipts basis by an accountant, Daniel D. Contarsy, from information furnished by the defendant. Contarsy had no knowledge of the receipt by [fol. 16] the defendant of funds from the Harlew Agencies, Inc. or the Security Mutual Life Insurance Company, and none of such funds were reported by defendant in his returns for the years 1951 to 1954 inclusive. (Tr. 35, 37, 427 to 429).

The Court Finds, as Ultimate Facts, Necessarily Inhering in a General Finding of Guilt, and Concludes as a Matter of Law the Following:

1. The sums received by defendant from Harlew Agencies, Inc. and Security Mutual Life Insurance Company, during the years 1951, 1952, 1953 and 1954, totaling $110,451.35; $207,765.81; $390,867.81; and $29,561.69 respectively, constitute taxable income and, accordingly, defendant was under a duty, and required by law, to report such sums in his tax returns. The Federal income tax is levied on the net gains, profit and income derived from any source whatever. The tax is imposed on gains or income whether acquired in a lawful or unlawful manner, including income acquired by embezzlement. That a taxpayer's mode of receipt may be illegal, or that his freedom to dispose of a gain may be assailable by someone with a better title to it, has no bearing on whether the gain is income under the tax laws. The law is that financial or monetary gain to a taxpayer, whether lawfully or unlawfully acquired, constitutes taxable income to the taxpayer in the year when he has such control over it that, as a practical matter, he derives readily realizable economic value from it. It is immaterial whether the receipt of funds by a taxpayer results from misappropriation, embezzlement, or from other lawful or unlawful acts. The fact that in a subsequent year or years a taxpayer has made restitution of part, or all of funds previously received, is of no significance in determining whether the funds were taxable gains in the year in which they were received or appro-

[fol. 17] priated by him. The precise nature of the criminal activity involved, whether it be embezzlement or other crimes, if any, in acquiring the funds here in dispute is not determinative of, and has no bearing on, the question whether such funds are taxable gains to the defendant. Hence, whether the misappropriation or diversion of funds by the defendant constituted, or may be regarded as constituting, the crime of embezzlement, or larceny, or grand theft, or obtaining money by false pretenses, or some other crime or crimes under the applicable state laws is a matter neither relevant nor material to the issues here presented.

2. The defendant, on February 27, 1952, filed a false and fraudulent Federal Income Tax Return for the calendar year 1951, wherein he stated that his net income was $13,375.74 and that the tax due thereon was $2,353.44; whereas his correct net income for that year was $123,827.09 upon which there was due and owing to the United States of America a tax of $70,037.12. The defendant therefore understated his income by $110,451.35 and his tax by $67,683.68 on his return for the year 1951.

3. The defendant on March 4, 1953, filed a false and fraudulent Federal Income Tax Return for the calendar year 1952, wherein he stated that his net income was $23,203.27 and that the tax due thereon was $5,997.38; whereas his correct net income for that year was $230,969.08 upon which there was due and owing to the United States of America a tax of $163,945.75. The defendant therefore understated his income by $207,765.81 and his tax by $157,948.37 on his return for the year 1952.

4. The defendant on March 12, 1954 filed a false and fraudulent Federal Income Tax Return for the calendar year 1953, wherein he stated that his net income was $15,223.15 and that the tax due thereon was $3,107.88; whereas his correct net income for that year was $406,090.96, upon which there was due and owing to the United [fol. 18] States of America a tax of $324,275.68. The defendant therefore understated his income by $390,867.81 and his tax by $321,167.80 on his return for the year 1953.

5. The defendant on April 15, 1955 filed a false and fraudulent Federal Income Tax Return for the calendar year 1954 wherein he stated that his net income was $15,809.58 and that the tax due thereon was $2,962.88; whereas his correct net income for that year was $45,371.27 upon which there was due and owing to the United States of America a tax of $15,847.90. The defendant therefore understated his income by $29,561.69 and his tax by $12,885.02 on his return for the year 1954.

6. Defendant's actions in filing false and fraudulent returns for the years 1951, 1952, 1953 and 1954 were willful and were done in a knowing and conscious attempt to evade and defeat a large part of his and his wife's Federal Income Taxes.

J. S. Perry, Judge.

May 11, 1959.

IN UNITED STATES DISTRICT COURT

JUDGMENT ORDER—May 11, 1959

On this 11th day of May, 1959 came the attorney for the government and the defendant appeared in person and by his counsel and the Court now having heard the defendant's objections to findings of the Government and being fully advised it is Ordered that certain objections be and they are hereby sustained and that certain objections be and they are hereby overruled

It Is Adjudged that the defendant has been convicted [fol. 19] upon his plea of not guilty and a finding of guilty of the offense of Sections 145(b) and 7201, Title 26, United States Code (Wilfully and knowingly attempting to evade and defeat a large part of income tax due and owing to the United States of America) as charged and the court having asked the defendant whether he has anything to say why judgment should not be pronounced, and no sufficient cause to the contrary being shown or appearing to the Court,

It Is Adjudged that the defendant is guilty as charged and convicted.

It Is Adjudged that the defendant is hereby committed to the custody of the Attorney General or his authorized representative for imprisonment for a period of One (1) Year on Count 1 and for a period of Two (2) Years on Counts 2, 3 and 4 of the Indictment, that the sentences imposed on Counts 2, 3 and 4 shall run concurrently with each other but consecutively to and follow the sentence imposed on Count 1

It Is Ordered that execution of sentence be and the same is hereby stayed until May 12, 1959 at 2 P.M.

It Is Further Ordered that appeal bond be and the same is hereby fixed at the sum of Fifteen Thousand Dollars ($15,000.00) with the defendant's wife to sign said bond as surety thereon

It Is Ordered that the Clerk deliver a certified copy of this judgment and commitment to the United States Marshal or other qualified officer and that the copy serve as the commitment of the defendant.

J. S. Perry, United States District Judge.

[fol. 20] The Court recommends commitment to: [8]

May 11, 1959

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[1] Insert "by counsel" or "without counsel; the court advised the defendant of his right to counsel and asked him whether he desired to have counsel appointed by the court, and the defendant thereupon stated that he waived the right to the assistance of counsel." [2] Insert (1) "guilty," (2) "not guilty, and a verdict of guilty," (3) "not guilty, and a finding of guilty," or (4) "nolo contendere," as the case may be. [3] Insert "in count(s) number _____" if required. [4] Enter (1) sentence or sentences, specifying counts if any; (2) whether sentences are to run concurrently or consecutively and, if consecutively, when each term is to begin with reference to termination of preceding term or to any other outstanding unserved sentence; (3) whether defendant is to be further imprisoned until payment of the fine or fine and costs, or until he is otherwise discharged as provided by law. [5] Enter any order with respect to suspension and probation. [8] For use of Court wishing to recommend a particular institution.

IN UNITED STATES DISTRICT COURT

NOTICE OF APPEAL—Filed May 12, 1959

Name and Address of Appellant:

Eugene C. James
Leask Lane
Wheaton, Illinois

Name and Address of Appellant's Attorneys:

Joseph E. Green
One North La Salle Street
Chicago 2, Illinois

Richard E. Gorman
One North La Salle Street
Chicago 2, Illinois

[fol. 21] Offense:

Violation of Section 145(b) of the Internal Revenue Code of 4939 (26 U.S.C. 145(b)) and Section 7201 of the Internal Revenue Code of 1954 (26 U.S.C. 7201), that is to say, willfully attempting the evasion of payment of income taxes for each of the years 1951, 1952, 1953, and 1954.

Concise Statement of Judgment or Order giving Date of any Sentence:

Finding of Guilty by the Court on May 8, 1959, with judgment on such finding, and sentence of the defendant, Eugene C. James, to the custody of the Attorney General for a period of one year on Count I, and two years on each of Counts II, III, and IV, the sentences on Counts II, III, and IV to be consecutive to the sentence on Count I, but concurrent with each other.

Name of Institution where Defendant now Confined, if not on Bail:

Defendant released on bail.

I, the above named appellant, hereby appeal to the United States Court of Appeals for the Seventh Circuit from the above stated judgment.

Dated: May 11, 1959.

Eugene C. James

Joseph E. Green, Richard E. Gorman, One North La Salle Street, Chicago 2, Illinois, CEntral 6-7722.

[fol. 22] CERTIFICATE OF MAILING (omitted in printing).

Clerk's Certificate to Foregoing Transcript (omitted in printing).

[fol. 25]

IN UNITED STATES COURT OF APPEALS

FOR THE SEVENTH CIRCUIT

No. 12719 September Term, 1959

September Session, 1959

UNITED STATES OF AMERICA, Plaintiff-Appellee,

v.

EUGENE C. JAMES, Defendant-Appellant.

Appeal from the United States District Court for the Northern District of Illinois, Eastern Division.

OPINION—December 29, 1959

Before Schnackenberg and Knoch, Circuit Judges, and Platt, District Judge.

Schnackenberg, Circuit Judge. After a trial without a jury, the district court found defendant Eugene C. James

guilty of wilfully attempting to defeat and evade a large part of income tax due and owing by him and his wife for each of the years 1951 to 1954 inclusive, as alleged in a four count indictment. From judgment entered on the said findings, defendant has appealed.

The facts are not in dispute. The monies obtained by defendant amounting to over $700,000, which were not included in his returns for the taxable years, were misappropriated by him, partly from a union entity and partly from an insurance company, by means which made him guilty of the crime of embezzlement of such funds as a principal, under applicable laws of New Jersey. Defendant and one Saperstein were indicted for said embezzlement in New Jersey and an order of extradition of defendant from Illinois to New Jersey was affirmed by the [fol. 26] Illinois Supreme Court, *James* v. *Lynch*, 16 Ill. 2d 380 (1959), and a petition for rehearing denied May 19, 1959.

Defendant argues that the receipt of embezzled funds, where the embezzlement has been made the subject of criminal prosecution, and when the fact that the funds were obtained by the crime of embezzlement has been specifically found by the trial court, does not constitute taxable income to the embezzler. He relies on *Commissioner* v. *Wilcox*, 327 U.S. 404 (1946). However, plaintiff contends that, as applied to the facts in this case, the *Wilcox* interpretation of section 22 (a)[1] was rejected by *Rutkin* v. *U.S.*, 343 U.S. 130 (1952). In *Rutkin*, it was held that money obtained by extortion constitutes taxable income to the extortioner. The court applied this test, at 137:

> An unlawful gain, as well as a lawful one, constitutes taxable income when its recipient has such control over it that, as a practical matter, he derives readily realizable economic value from it. *Burnet* v. *Wells*, 289 U.S. 670, 678; *Corliss* v. *Bowers*, 281 U.S. 376, 378. • • •

[1] 26 U.S.C.A. (1939 I.R.C.) § 22 (a).

The court referred, at 138, to *Wilcox* in these words:

> We do not reach in this case the factual situation involved in *Commissioner* v. *Wilcox*, 327 U.S. 404. We limit that case to its facts. There embezzled funds were held not to constitute taxable income to the embezzler under § 22 (a). The issue here is whether money extorted from a victim with his consent induced solely by harassing demands and threats of violence is included in the definition of gross income under § 22 (a). We think the power of Congress to tax these receipts as income under the Sixteenth Amendment is unquestionable. The broad language of § 22 (a) supports the declarations of this Court that Congress in enacting that section exercised its full power to tax income. We therefore conclude that § 22 (a) reaches these receipts.

Three years later, in *Commissioner* v. *Glenshaw Glass Co.*, 348 U.S. 426 (1955), the court cited *Rutkin* in support of its holding, at 429-430, that Congress, in enacting sec- [fol. 27] tion 22 (a), "applied no limitations as to the source of taxable receipts, nor restrictive labels as to their nature"; and that it thereby intended "to tax all gains except those specifically exempted", and thus (433), "to bring the taxing power to bear upon all receipts constitutionally taxable * * *."

Again, whereas the *Wilcox* interpretation resorted to *state* law in determining the absence of a bona fide claim of right to the alleged gain and the existence of an obligation to repay it, *Rutkin* made no resort to state law. Instead it recognized the well settled principle that in matters of federal taxation "Congress establishes its own criteria and the state law may control only when the federal taxing act by express language or necessary implication makes its operation dependent upon state law", *Lyeth* v. *Hoey*, 305 U.S. 188, 194 (1938). See also, *United States* v. *Pelzer*, 312 U.S. 399 (1941); *Jerome* v. *United States*, 318 U.S. 101 (1943); *Estate of Putnam* v. *Commissioner*, 324 U.S. 393 (1945). Thus *Rutkin* was an interpretation of section 22 (a) in keeping with precedent, and

the economic use and benefit test there announced—unlike the claim of right test of *Wilcox*—provided a rule of law susceptible of ready and uniform application to all unlawful gains, however acquired.

For the reasons herein set forth, the judgment of the district court is affirmed.

Affirmed.

[fol. 28]

IN UNITED STATES COURT OF APPEALS

FOR THE SEVENTH CIRCUIT

No. 12719

UNITED STATES OF AMERICA, Plaintiff-Appellee,

vs.

EUGENE C. JAMES, Defendant-Appellant.

Appeal from the United States District Court for the Northern District of Illinois, Eastern Division.

JUDGMENT—December 29, 1959

This cause came on to be heard on the transcript of the record from the United States District Court for the Northern District of Illinois, Eastern Division, and was argued by counsel.

On consideration whereof, it is ordered and adjudged by this court that the judgment of the said District Court in this cause appealed from be, and the same is hereby, Affirmed, in accordance with the opinion of this Court filed this day.

[fol. 29]

IN UNITED STATES COURT OF APPEALS

FOR THE SEVENTH CIRCUIT

[Title omitted]

ORDER EXTENDING TIME TO FILE PETITION FOR REHEARING—February 8, 1960

On consideration of the motion of counsel for defendant-appellant for extension of time in which to file petition for rehearing, and affidavits in support of said motion, counsel for plaintiff-appellee having filed no objections thereto,

It Is Hereby Ordered that the time within which defendant-appellant may file a petition for rehearing in this cause be extended for five (5) days from this date.

[fol. 30]

IN UNITED STATES COURT OF APPEALS

[Title omitted]

ORDER DENYING PETITION FOR REHEARING—February 29, 1960

It is ordered by the Court that the petition for a rehearing of this cause be, and the same is hereby, Denied.

[fol. 31] Clerk's Certificates to Foregoing Transcript (omitted in printing).

[fol. 32]

SUPREME COURT OF THE UNITED STATES

No. 820, October Term, 1959

EUGENE C. JAMES, Petitioner,

vs.

UNITED STATES.

ORDER ALLOWING CERTIORARI—May 16, 1960

The petition herein for a writ of certiorari to the United States Court of Appeals for the Seventh Circuit is granted, and the case is transferred to the summary calendar.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

FILE COPY

Office-Supreme Court, U.S.
FILED
MAR 26 1960
JAMES R. BROWNING, Clerk

IN THE

Supreme Court of the United States

OCTOBER TERM, 1959

No. 823 63.

EUGENE C. JAMES,

Petitioner,

vs.

UNITED STATES OF AMERICA,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

JOSEPH E. GREEN,
RICHARD E. GORMAN,
One North LaSalle Street,
Chicago 2, Illinois,
Attorneys for Petitioner.

The Scheffer Press, Inc.—ANdover 3-6850

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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1959.

No.

EUGENE C. JAMES,

Petitioner,

vs.

UNITED STATES OF AMERICA,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

To The Honorable, The Chief Justice and Associate Justices of The Supreme Court of The United States:

Your petitioner, Eugene C. James, respectfully prays that a writ of certiorari be issued to review the decision of the United States Court of Appeals for the Seventh Circuit in the above case.

JUDGMENT AND OPINION OF THE COURTS BELOW.

The judgment of the United States District Court for the Northern District of Illinois, Eastern Division, was entered on May 11, 1959 and is not reported.

The opinion of the United States Court of Appeals for the Seventh Circuit, affirming said judgment, was filed December 29, 1959 and is included in the Appendix hereto and in the certified copy of the Record.

JURISDICTION.

The opinion of the United States Court of Appeals was filed December 29, 1959. A Petition for Rehearing was denied February 29, 1960. This petition is filed within 30 days of that date. The jurisdiction of this Court is invoked under 28 U.S.C. Section 1254(1), 62 Stat. 928.

QUESTION PRESENTED.

Was it not reversible error for the Court of Appeals to hold, as did the Trial Court, that the receipt of embezzled funds, where the embezzlement thereof is actual, the fact of such embezzlement having been specially found, and where the embezzlement was made the subject of criminal prosecution, constitutes the receipt of taxable income in the hands of the embezzler?

STATEMENT OF THE CASE.

This prosecution was commenced on December 13, 1957, by the return of an Indictment in four Counts under Section 145(b) of the Internal Revenue Code of 1939 (26 U.S.C. 145 (b)) and Section 7201 of the Internal Revenue Code of 1954 (26 U.S.C. 7201). The first Count of the Indictment charged the petitioner with wilfully attempting to defeat and evade a large part of the income tax due and owing by him and his wife to the United States for the year 1951 by filing a joint return for that year showing $2,353.44 due, whereas it is alleged that the petitioner knew that there was $70,037.14 owing for his tax liability for that year. The second Count charged the same offense for the year 1952, the return showing $5,997.38 due, whereas it was alleged that the petitioner knew there was due $166,195.67. The third Count related to the year 1953, for which the return showed a tax liability of $3,107.88, whereas it was alleged that the petitioner knew the amount due was $325,323.04. The fourth Count

concerned the year 1954 for which the tax liability as reported was $2,962.88, whereas the Indictment alleged the petitioner knew that the amount due was $15,847.90.

The cause was tried to the court upon waiver of trial by jury, consented to by the government and approved by the court. At the close of the evidence for the prosecution the petitioner orally moved for a judgment of acquittal, which motion was denied.

At the close of all of the evidence, the petitioner again moved orally for a judgment of acquittal, which motion was again denied. The court then found the petitioner guilty on each Count.

The court, acting under Rule 23(c) of the Federal Rules of Criminal Procedure, entered most detailed Findings of Fact, specially finding all material facts as disclosed by the evidence and additionally finding ultimate facts and conclusions of law (Petitioner's Appendix to Brief p. 7a).

Because of the detailed and fulsome Special Findings of Fact entered by the Trial Judge, which appear in their entirety in the Appendix to the petitioner's brief filed in the Court of Appeals at pages 7a to 18a with which special findings the Government is in agreement, it is believed unnecessary in this Statement of Facts for this Petitioner to do other than here again, for the convenience of this Court, repeat such special findings as the same were made and entered by the Court, as the tryer of the facts.

"Petitioner filed timely joint income tax returns for himself and his wife of the years 1951, 1952, 1953 and 1954 with the District Director of Internal Revenue at Chicago, Illinois.

"The income reported by petitioner on his returns consisted of salary received from the Laundry Workers Union, Local No. 46, located in Chicago, Illinois; salary from the Laundry Workers International Union, whose headquarters were in Indianapolis, Indiana; salary from Local No. 985 of the International Brotherhood of Teamsters, located in Detroit, Michigan; certain payments received as a Welfare Deputy for the aforementioned Local No. 46; certain expense monies received from aforementioned Local No. 46. He also reported net losses from the operation of a racing stable.

"From January 1, 1950 to August 7, 1952, petitioner was seventh Vice President and Acting General Secretary and Treasurer of the Laundry Workers International Union. From August 7, 1952 to December 31, 1954 defendant was General Secretary and Treasurer of the Laundry Workers International Union. In addition, he was Deputy Trustee in charge of Local No. 46 of the Laundry Workers Union from May 13, 1949 until October, 1954, during which period the Local was under a trusteeship. Upon termination of the trusteeship in October, 1954, he became Secretary and Treasurer of the Local.

"Throughout the years 1951 to 1954 inclusive there was in existence a welfare trust known as the Social Security Department of the Laundry Workers International Union. The trust had been created pursuant to a mandate of the 1949 Convention of the Laundry Workers International Union. The Social Security Department was an entity separate and distinct from the Laundry Workers International Union. The purpose of the trust known as the Social Security Department was to provide welfare benefits for union members. The Social Security Department was governed by six trustees, three of whom were selected by Management and three by Labor. At no time was the

defendant a trustee or other officer of the Social Security Department.

"Petitioner was appointed Welfare Deputy for Laundry Workers Local No. 46 of Chicago under a written agreement with the Social Security Department executed in October 9, 1950. This agreement provided, among other things, that petitioner was to receive 5 per cent of all premiums payable to the Security Mutual Life Insurance Company under the latter's contract covering members of Local No. 46, and that expenses incurred by defendant in investigating claims were to be paid by him out of this sum. The agreement between petitioner and the Social Security Department contained the following clause:

> "* * * Should any surplus remain after payment of said items then it may be retained [by petitioner], provided, however, that such surplus shall be reported as income [by petitioner] in accordance with law. * * *"

In his returns for the years in question, petitioner reported as gross income sums allegedly representing the difference between the amounts received and the amounts expended under the agreement.

"The Social Security Department received payments from various employers throughout the country on behalf of union employees, which payments were deposited by the bookkeeper for the Social Security Department in the Indiana National Bank of Indianapolis, Indiana. The receipt of these funds was regularly recorded by the bookkeeper of the Social Security Department.

"From April, 1950 to and including October 1, 1953, the Security Mutual Life Insurance Company of Binghamton, New York, by contract with the Social Security Department of the Laundry Workers International Union,

had in effect health and accident insurance policies covering the members of the various laundry workers' locals throughout the country. For the period March 1951 to October 1, 1953, premiums on the health and accident policies were paid by the Social Security Department to one Louis B. Saperstein of Newark, New Jersey, an insurance broker and agent for the Security Mutual Life Insurance Company.

"Louis B. Saperstein was the Managing Officer of two insurance brokerage firms known as the Harlew Agency of Illinois, Inc. and the Harlew Agency of California, Inc. All checks for payment of premiums to the Security Mutual Life Insurance Company by the Social Security Department were made payable to Louis B. Saperstein and were deposited by him, or persons employed by him, in bank accounts of either Harlew Agency of Illinois, Inc. or Harlew Agency of California, Inc.

"The funds received by Louis Saperstein from the Social Security Department during the years 1951 to 1953 inclusive were wholly disbursed by him for the following purposes:

(a) Payments to the Security Mutual Life Insurance Company of Binghamton, New York, as premiums on the policies in existence between that company and the Social Security Department for the Laundry Workers International Union;

(b) Payment of claims made by laundry worker employees who, under the terms of the policies, were ineligible to receive benefits from the Security Mutual Life Insurance Company;

(c) By checks drawn to the Order of the Laundry Workers International Union and Mailed to the defendant at his residence in Wheaton, Illinois, or at his office in the headquarters of Local No. 46 of the Laundry Workers International Union at 1640 West Van Buren Street, Chicago, Illinois.

"On September 14, 1951, petitioner opened a bank account at the Merchants National Bank, Chicago, Illinois, in the name of the Laundry Workers International Union. This bank account was opened without the authorization of the Laundry Workers International Union or the Social Security Department. The signature card for this bank account required only the signature of petitioner to effect withdrawals from the account.

"Petitioner deposited in the above-mentioned Merchants National Bank account all checks received by him from Saperstein which were payable to the Laundry Workers International Union, and which were drawn on accounts of Harlew Agency of Illinois, Inc. and Harlew Agency of California, Inc.

"The funds so received by petitioner and deposited by him in the Merchants National Bank during the years 1951, 1952, 1953 and 1954 amounted to $80,451.35; $175,265.81; $368,367.81, and $29,561.69 respectively.

"*The funds referred to in (the preceding two paragraphs) were under the laws and statutes of the State of New Jersey embezzled by the petitioner, and that under the laws and statutes of such State, the petitioner, James, is guilty of the crime of embezzlement of such funds as a principal, along with Saperstein.* (Emphasis supplied.)

"That Saperstein and the petitioner were jointly indicted for the crime of conspiracy to embezzle and for

the crime of embezzlement of the funds in question by the Grand Jurors of Essex County, New Jersey, and that such indictment is now pending in the courts of that state; and the petitioner has been ordered extradited for trial in New Jersey by order of the Circuit Court of Du Page County, Illinois, which order was affirmed by the Supreme Court of Illinois on March 20, 1959; that there is now pending before the Supreme Court of Illinois a petition for rehearing of the aforesaid order of affirmance.

"By letters dated July 17, 1951 and July 27, 1951, petitioner stated to the Security Mutual Life Insurance Company that members of the Laundry Workers International Union were performing services and incurring expenses in connection with the promotion of the welfare plans, and that in his opinion such functions and expenses were properly the burden of the insurance company. Accordingly, he requested that the insurance company consider reimbursing the union for these expenditures. By letter dated September 10, 1951, addressed to defendant, the insurance company agreed to pay the union $2,500.00 a month as reimbursement for such expenses. The agreement was made retroactive to January, 1951. Pursuant to this agreement, one check for $20,000.00, covering the retroactive period, was made payable to the Laundry Workers International Union; one check for $2,500.00 was made payable to E. C. James; the remaining monthly checks in the amount of $2,500.00 each were made payable to E. C. James, Acting Secretary-Treasurer of the Laundry Workers International Union. All of the checks were mailed to petitioner, endorsed by rubber stamp, and deposited by him in the above-mentioned account at the Merchants National Bank. For the years 1951, 1952 and 1953 the sums so received and de-

posited by the petitioner totaled $30,000.00, $32,500.00 and $22,500.00 respectively. The representations made by the petitioner to the Security Mutual Life Insurance Company in the aforementioned letters, as a result of which the above sums of $2,500.00 a month were paid by the insurance company, were made without authorization of any other officer of the Laundry Workers International Union or any trustee of the Social Security Department.

"*That the acts of the petitioner referred to in (the preceding paragraph) constituted the crime of embezzlement of the $85,000.00 therein referred to under the laws and Statutes of the State of Illinois.* (Emphasis supplied.)

"On numerous occasions during the years 1951 to 1954 inclusive, petitioner visited the Merchants National Bank of Chicago, Illinois, and drew checks on the account maintained by him at this bank in the name of the Laundry Workers Interational Union. These checks were drawn to the order of E. C. James and were immediately cashed by him at the bank. During the years in question, petitioner received from the above sources (*i.e.*, the Harlew Agencies, Inc. and the Security Mutual Insurance Company) and deposited in the Merchants National Bank the following sums:

1951	$110,451.45
1952	207,765.81
1953	390,867.81
1954	29,561.69
Total	$738,646.66.

By May 6, 1954, petitioner had withdrawn all funds which he had deposited in this account.

"None of the funds in question were paid over by the petitioner to the Laundry Workers International Union or the Social Security Department, and no part of the funds was expended by the petitioner for the benefit of the aforementioned union entities.

"During the years involved petitioner maintained safe deposit boxes at the Gary-Wheaton Bank in Wheaton, Illinois, the town in which he resided, to which safe deposit boxes he made frequent entries. During the year 1951 he made nineteen visits to the boxes; during the year 1952 he made twenty-two visits to the boxes; during the year 1953 he made nineteen visits to the boxes; during the year 1954 he made ten visits to the boxes.

"Throughout the period in question, petitioner also maintained three checking accounts and one savings account at the Gary-Wheaton Bank at Wheaton, Illinois. In addition, he maintained two checking accounts at the Central National Bank in Chicago, Illinois. Petitioner made cash deposits to his accounts at the Gary-Wheaton Bank in each of the years 1951, 1952, 1953 and 1954 totaling $27,990.00, $51,860.00, $15,200.00, and $14,310.00 respectively.

"In addition to the currency deposits during this time, which exceeded $109,000.00, defendant purchased a horse from Leopha Wilson in November, 1953, for $10,000.00 in currency. This currency was not withdrawn from any of defendant's bank accounts.

"On November 17, 1953 petitioner purchased a cashier's check at the Gary-Wheaton Bank in the amount of $2,500.00. There was no withdrawal of a like amount from any of his bank accounts on this date. However, on this same date he made an entry into his safe deposit

box at the Gary-Wheaton Bank. As testified to by Matthew J. Dooley, there was mailed to petitioner on December 28, 1953, $27,000.00 worth of stock in the Founders Syndicate of America, Inc., the certificates of which were made out in dummy names and endorsed in blank. This stock resulted from a purchase by Dooley on behalf of a group, including petitioner, which group, in the presence of Dooley, had agreed to produce the funds to buy the stock.

"An analysis of petitioner's various bank accounts does not show the withdrawal of $27,000.00 or the withdrawal of any series of checks which would account for the $27,000.00. Petitioner's contribution for the purchase of the stock was by cash not withdrawn from his bank accounts.

"None of the funds withdrawn by petitioner from his several accounts at the Gary-Wheaton Bank and the Central National Bank of Chicago during the years 1951 through 1954 were expended on behalf of the Laundry Workers International Union or the Social Security Department, but instead were expended in part for his personal use and benefit.

"The funds received by the petitioner during the years 1951, 1952, 1953 and 1954, which he deposited in the Merchants National Bank of Chicago, Illinois, and subsequently withdrew therefrom, were within his complete dominion and control, and large portions thereof were actually expended by him for his personal benefit. By the receipt of these funds he derived readily realizable economic value in the year of receipt.

"Petitioner's tax returns for the years in question were prepared on the cash receipts basis by an accountant, Daniel D. Contarsy, from information furnished by

the petitioner. Contarsy had no knowledge of the receipt by the petitioner of funds from the Harlew Agencies, Inc. or the Security Mutual Life Insurance Company, and none of such funds were reported by petitioner in his returns for the years 1951 to 1954 inclusive."

Thus, under the facts in this case, the same were recited by the detailed special findings of the trial court, the entirety of the monies obtained by the petitioner which were not included in his returns for the taxable years in question, were funds of which the petitioner obtained by means which caused him to be "guilty of the crime of embezzlement of such funds as a principal" (Petitioner's Appendix to Brief p. 11a).

STATUTES CONCERNED.

Internal Revenue Code of 1939:.

SEC. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service • • • of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. • • •

(26 U.S.C. 1952 ed., Sec. 22(a).)

SEC. 145. PENALTIES.

(b) *Failure to Collect and Pay Over Tax, or Attempt to Defeat Tax.*—Any person required under this chapter to collect, account for, and pay over any tax imposed by this chapter, who willfully fails to collect or truthfully account for and pay over such tax, and any person who willfully attempts in any manner to evade or defeat any tax imposed by this chapter or the payment thereof, shall, in addition to other penalties provided by law, be guilty of a felony and, upon conviction thereof, be fined not more than $10,000 or imprisoned for not more than five years, or both, together with the costs of prosecution.

• • •

(26 U.S.C. 1952 ed., Sec. 145(a).)

Internal Revenue Code of 1954:

SEC. 61. GROSS INCOME DEFINED

(a) *General definition.*—Except as otherwise provided in this subtitle, gross income means all income from whatever source derived, • • •

• • •

SEC. 7201. ATTEMPT TO EVADE OR DEFEAT TAX

Any person who willfully attempts in any manner to evade or defeat any tax imposed by this title or the payment thereof shall, in addition to other penalties provided by law, be guilty of a felony and, upon conviction thereof, shall be fined not more $10,000, or imprisoned not more than 5 years, or both, together with the costs of prosecution.

(26 U.S.C. 1952 ed., Supp. IV, Sec. 7201.)

REASONS FOR GRANTING THE WRIT.

1. The Court of Appeals has decided an important federal question in a way in conflict with the applicable decisions of this Court.

2. The Court of Appeals has rendered a decision in conflict with decisions of other Courts of Appeal.

1.

This Supreme Court in the case of *Commissioner of Internal Revenue* v. *Laird Wilcox*, 327 U.S. 404, 416, 90 L. 752-759, in an opinion handed down on February 25, 1946, made what was the first, the last and only direct expression by the Court on the taxability of embezzled funds. In *Wilcox*, the taxpayer, a bookkeeper for a transfer and warehouse company in Reno, Nevada, had over a five year period from 1939 through 1942 diverted miscellaneous sums of money belonging to his principal, pocketing them, and thereafter losing practically all of his ill-gotten gains in various gambling houses in Reno. His improper takings during the calendar year of 1941 amounted to $12,748.60. His acts constituted criminal embezzlement under the laws of Nevada, and for this crime he was indicted and convicted in the courts of that state in 1942, and sentenced to serve from 2 to 4 years in prison, from which he was paroled in 1943. The Commissioner determined that the taxpayer was required to report the $12,748.60 which he embezzled during 1951 and in this determination was sustained by the Tax Court. After the reversal of the Tax Court by the decision of the Ninth Circuit above referenced, certiorari was granted "because of a conflict among circuits as to the taxability of *embezzled* money". (Emphasis supplied).

The Government argued (as it does here, in the case at bar) that taxability rested "upon the enjoyment by the taxpayer of privileges and benefits so substantial and important as to make it reasonable and just to deal with him as if he were the owner, and to tax him on that basis." To this argument the Supreme Court said "We cannot agree," continuing:

> "Taxable gain is conditioned upon (1) the presence of a claim of right to the alleged gain and (2) the absence of a definite, unconditional obligation to repay or return that which would otherwise constitute a gain. Without some bona fide legal or equitable claim, even though it be contingent or contested in nature, the taxpayer cannot be said to have received any gain or profit within the reach of Section 22(a). See *North American Oil Consolidated* v. *Burnett*, 286 U.S. 417, 424, 76 L.ed. 1197, 1200. Nor can taxable income accrue from the mere receipt of property or money which one is obligated to return or repay to the rightful owner, as in the case of a loan or credit."
>
> * * *
>
> "We fail to perceive any reason for applying different principles to a situation where one embezzles or steals money from another. Moral turpitude is not a touchstone of taxability. The question, rather, is whether a taxpayer received a statutory gain, profit or benefit. That the taxpayer's motive may have been reprehensible or the mode of receipt illegal has no bearing upon the application of Section 22(a).
>
> "It is obvious that the tapayer in this instance in embezzling the $12,748.60, received the money without any semblance of a bona fide claim of right. And he was at all time under an unqualified duty and obligation to repay the money to his employer. Under Nevada law, the crime of embezzlement was complete whenever an appropriation was made; the employer was entitled to replevy the money as soon as it was

appropriated or to have it summarily restored by a magistrate. The employer, moreover, at all times held the taxpayer liable to return the full amount. The debtor-creditor relationship was definite and unconditional. All right, title, and interest in the money rested with the employer. The taxpayer thus received no taxable income from the embezzlement.

"This conclusion is unaltered by the fact that the taxpayer subsequently dissipated all of the embezzled funds in gambling houses. The loss or dissipation of money cannot create taxable income here any more than the insolvency or bankruptcy of an ordinary borrower causes the loans to be treated as taxable income to the borrower."

* * *

"Sanctioning a tax under the circumstances before us would serve only to give the United States an unjustified preference as to part of the money which rightfully and completely belongs to the taxpayer's employer.

"*The Tax Court's determination that the embezzled money constituted taxable income to the embezzler, a result in accord with its prior decisions on the issue, involved a clear-cut mistake of law.* The court below was, therefore, justified in reversing that judgment." (Emphasis supplied.)

Prior to this holding among the Circuits themselves, no unanimity existed. The Eighth Circuit by its decision in *Kurrie* v. *Helvering*, 126 F. 2d 733 (Mar. 14, 1942), in affirming an order of the Board of Tax Appeals taxing an embezzler from an Iowa bank upon the proceeds of his embezzlement and the profits earned by the use of such funds, had held that although the embezzler was a trustee *ex malificio*, "embezzled funds and profits earned by the embezzler through the use of such funds constitute taxable income." In the Fifth Circuit, however, less than two

months after the *Kurrle* case, a diametrically contrary view as adopted in the case of *McKnight* v. *Commissioner of Internal Revenue*, 127 F. 2d 572 (Apr. 29, 1942). It was in order to resolve this conflict, that this Supreme Court granted the Government's application for certiorari in *Wilcox* v. *Commissioner of Internal Revenue*, 148 F. 2d 933, Ninth Cir., (Mar. 30, 1954), wherein the *McKnight* case's reasoning had been sanctioned.

Subsequent to *Wilcox*, the Internal Revenue Service itself in General Counsel Memo. 24945, Cum. Bull. 1946-2, 27 reversed its prior position regarding the taxability of embezzled funds such as in the *Wilcox* case, and recognized them not to be taxable.

From the position enunciated in this General Counsel Memo. the Internal Revenue Service has never retreated and this Memo. is in full force and effect today.

It is to be noted that *Wilcox* did not hold, as has heretofore in some cases been incorrectly argued on behalf of various taxpayers, that the illegality of the means by which the funds were obtained thereby rendered them nontaxable. This is clearly not, now and has never been the law. Unlawful gains, where the same are realize under a claim of right and without a definite and unconditional obligation to repay, are taxable equally with lawful gains, and such state of the law was not disturbed by *Wilcox* The sole question authoritatively and finally determined by *Wilcox* was the express recognition of the non-taxability of moneys obtained wrongfully—without claim of right—when the obtention of such moneys created a definite and unconditional obligation to return the same.

After the decision in the *Wilcox* case and the following General Counsel's Memo referenced above, no question as

to the non-taxability of funds so obtained seems to have been raised in reported decisions until 1952.

However, on March 24, 1952, this Supreme Court, handed down the decision in the case of *Rutkin* v. *United States of America*, 343 U.S. 130, 96 L.ed. 833, 72 Sup. Ct. 571, holding money obtained by extortion to be taxable. The petition in the case at bar wishes to here and now state that with the *Rutkin* holding, he has no quarrel. Indeed, it is not felt that *Rutkin* in any way altered the law as it had been prior to *Wilcox* nor did it in any way change or obliterate in any part whatsoever the rule of *Wilcox*. Unfortunately, however, it must be acknowledged that *Rutkin* has formed the basis for much dicta, which is the effect that the rule of Wilcox was in some way diluted or modified by *Rutkin*. In fact, such was the view of the minority of the Court. However, the petitioner believes that the actual effect of *Rutkin* was merely to prevent an extension of *Wilcox's* doctrine into areas of taxability in which the law was already clear in affirming that gains were taxable. (See *Humphries* v. *Commissioner*, 125 F.2d 340, wherein extortion or kidnap proceeds had previously to *Rutkin* been held taxable and in which certiorari was denied in 317 U.S. 637, 87 L.ed. 513, 63 Sup. Ct. 28). *Rutkin* did not alter *Wilcox's* holding or destroy its rationale.

It is important here to closely analyze the facts in *Rutkin*. Rutkin was indicted for wilful failure to include in his tax return for 1943, $250,000.00 which he had received during that year from one Joseph Reinfeld. The circumstances of the receipt of the funds were complex. Reinfeld had been engaged in 1929 with the defendant in a bootlegging operation known as the "High seas venture". The defendant was taken into the enterprise because of

fear that he or his associate would otherwise create trouble, and was given a 6% interest in the venture for which he appears to have been paid. In 1933 (upon repeal of prohibition) Browne Vintners Co., a New York corporation, was organized to engage in the liquor business by Reinfeld and others. Rutkin was not included in this new venture, but thereafter asserted a claim of a 6% interest in this enterprise as well. In 1940 all of the stock of Brown Vintners was sold for $7,500,000.00 to a purchaser who also assumed $8,000,000.00 of the company's debts, but no money was then paid to Rutkin who was not a stockholder of record, nor a beneficial owner of any of the company's stock but who was nevertheless actively claiming and asserting an interest therein. Thereafter repeated demands were asserted by Rutkin upon Reinfeld for sums ranging up to $500,000.00, Rutkin "threatening use of a gun" and to "kill Reinfeld and Reinfeld's family unless his demands were met." Finally, in 1943, Reinfeld paid Rutkin the $250,000.00 in question, and *Rutkin thereupon signed and Reinfeld received a general release purporting to release Reinfeld, Browne Vintners Company and others from all claims of Rutkin.*

It is to be noted that this Supreme Court (page 134 of the Official Reports) pointed out in describing the demands of Rutkin:

> "Throughout this melodrama petitioner (Rutkin) asserted he was entitled to the payments he demanded from Reinfeld because of petitioner's former interest in Browne Vintners Company."

Thus, clearly, Rutkin received the money under a definite "claim of right". It is of no consequence that such claim was in fact invalid, and was not given credence by Reinfeld. The term "claim of right" means what the expression implies—a claim of right—not an actual right. Such

a claim of right was the basis upon which Rutkin demanded the money, then received the same, and for which he ultimately executed his written release. In the opinion below (*Rutkin* v. *United States*, 189 F.2d 431) the court applied the "claim of right" doctrine by holding that the extortioner received the money with a "semblance of a bona fide claim of right", since Reinfeld never denied the presence of a claim of right by him for some money, and the extortioner, when asking his victim for money, called it "my money", and gave a general release at the time he was given the money. As pointed out below "Reinfeld has unmistakably considered the $250,000 to be Rutkin's property. He left Rutkin in undisputed possession of it for the last eight years."

The Supreme Court declared such money, so obtained to be taxable. In its opinion, after recognizing that Rutkin's "control over the cash so received was such that, in the absence of Reinfeld's *unlikely repudiation* of the transaction and demand for the moneys' return, petitioner could enjoy its use as fully as though his title to it were unassailable", (emphasis supplied) and pointing out that unlawfully obtained income is taxable similarly to lawful gains, the Court said:

> "There is little doubt now that where unlawful gains are secured by the fraud of the taxpayer they are taxable. In the instant case it is not questioned that the $250,000 would have been taxable to petitioner if he had obtained it by fraudulently inducing Reinfeld to believe petitioner's false claims to be true. That being so, it would be an extraordinary result to hold here that petitioner is to be tax free because his fraud was so transparent that it did not mislead his victim and his victim paid him the money because of fear instead of fraud.

"We do not reach in this case the factual situation involved in *Commissioner* v. *Wilcox*, 327 US 404, 90 L.ed. 752, 66 S.Ct. 546, 166 ALR 884. We limit that case to its facts. There embezzled funds were held not to constitute taxable income to the embezzler under § 22(a). The issue here is whether money extorted from a victim with his consent induced solely by harassing demands and threats of violence is included in the definition of gross income under § 22(a)."

Clearly, it would seem, *Rutkin* does not overrule *Wilcox*. Indeed, quite on the contrary, it reaffirms *Wilcox*.

Very simply, *Rutkin* was an extortion—not an embezzlement case. Rutkin got the money claiming that he was entitled to it (although such claim was not valid, and the real reason for payment was fear of physical violence induced in the payor). Neither petitioner nor Wilcox claimed any right to the funds thus received. Rutkin got good legal title to the money, and, as pointed out by this Court, it was, as a practical matter, extremely unlikely that Reinfeld, who paid because of fear, would thereafter repudiate his deal and seek the recovery of the funds. Neither Wilcox nor petitioner, however, at any time obtained legal title to the money of which they took possession. The rightful owner of the same could (and in fact, in the case of petitioner actually did) pursue the same. In the petitioner's case, as in *McKnight* v. *Commissioner of Internal Revenue*, *supra*, "the takings were large, and under a system of bookkeeping that made discovery and the demand for recovery eventually certain." (See 127 F.2d at page 574.) Rutkin, on the contrary, obtained clear legal title to the funds, could and did use them as his own, and never at any time had occasion to fear or anticipate that any person whomsoever would challenge his title to the same. The money in

short was as a practical matter his. The money taken by petitioner and by Wilcox was not theirs.

It is to be observed that the two mandatory indicia of taxability established in *Wilcox, i.e.* (1) claim of right to the gain and (2) absence of a definite, unconditional obligation to repay still applied after *Rutkin*. In the *Rutkin* case there was both a claim of right and, in view of the circumstances of the extortion, there was a practical absence of a definite unconditional obligation to repay.

Although in no reported case whatsoever decided by any court, has *Wilcox* been overruled and although all cases recognize in varying degrees the rule of *Wilcox*, parts of the language of the decision in *Rutkin* has, from time to time, been relied upon in the opinions of lower courts as the basis for distinctions drawn from the *Wilcox* case. These cases have been set out in chronological order and the distinguishing features thereof pointed up in the petitioner's brief filed in the Court of Appeals and made a part of this Record from page 26 through page 40.

Thus, we find that in the decision of the Court of Appeals for the Seventh Circuit to which this petition is directed, the Court is in error, in holding as it does. "Thus *Rutkin* was an interpretation of Section 22(a) in keeping with precedent, and the economic use and benefit test there announced—unlike the claim of right test of *Wilcox*—provided a rule of law susceptible of ready and uniform application to all unlawful gains, however acquired."

The salient facts present in *Wilcox* and in the petitioner's case are in close analogy and are distinguishable from every case in which the doctrine of taxability enunciated in the *Wilcox* case was rejected by a Court of Appeals relying on the *Rutkin* theory.

2

The decision of the Court of Appeals for the Seventh Circuit to which this petition for certiorari is directed stands in direct conflict with the decision of the Court of Appeals for the Second Circuit in *J. J. Dix, Inc.* v. *Commissioner of Internal Revenue*, 223 F. 2d 436 (2d CA), June 2, 1955, cert. den. 350 U.S. 894, in which that Court expressly reaffirmed *Wilcox* in considering the tax liability of the president of a corporation for corporate funds in the amount of $56,736.82 which he had misappropriated. The language of the Court on the question was:

"The Tax Court held that Jacob Dix realized taxable income of $56,736.82, *i.e.*, the amount of corporate funds he misappropriated. We think this was erro Jacob withdrew those moneys from the corporate bank accounts without the consent, coerced or otherwise, of the company. That he was the president did not amount to corporate consent. We have here a simple case of embezzlement, not one involving a receipt under any color of right. Accordingly, we think *Commissioner of Internal Revenue* v. *Wilcox*, 327 U.S. 404, 66 S.Ct. 546, 90 L.Ed. 833, governs, and that *Rutkin* v. *United States*, 343 U.S. 130, 72 S.Ct. 571, 96 L.Ed. 833, does not apply. We do not believe that *Rutkin* completely obliterated *Wilcox*. 'Since the court in *Commissioner of Internal Revenue* v. *Wilcox* flatly held that embezzled funds were not taxable income to the embezzler and in the *Rutkin* case has unequivocally held that extorted funds were taxable income to the extortionist, the line of demarcation lies between those rather closely related factual situations and must be determined by the facts in the individual case.' *Marienfeld* v. *United States*, 8 Cir., 214 F.2d 632, 637. In the instant case, the facts are close to those of *Wilcox* and lack the distinguishing features found in *United States* v.

Bruswitz, 2 Cir., 219 F.2d 59, and cases there cited. See also the dissent of Judge Kalodne in *Kann* v. *Commissioner*, 3 Cir., 210 F.2d 247, 253."

Obviously, in the petitioner's case he is even closer to *Wilcox* than was Dix. In *James* the embezzler was not in control of the Union or the Insurance Company, whereas Dix was the president of the victim corporation. In the petitioner's case we have real, actual pursuit of the moneys embezzled, an utter absence of any claim of right, and, moreover, an existing prosecution for embezzlement and the fact of the embezzlement of the funds so found by the District Court.

The Court's attention is also invited to two recent District Court decisions wherein the *Rutkin* and *Wilcox* cases were closely examined. In *United States* v. *Peelle*, 159 F. Supp. 45, Eastern District of N.Y., February 4, 1958, so-called "secret" corporation bank accounts were used by Henry E. Peelle, an officer of the corporation, without knowledge or consent of other officers of the corporation, and moneys extracted therefrom for his own personal use. It seems difficult to perceive how a set of facts more closely analogous to the petitioner's case could be envisoned. The device utilized to effect the embezzlement in both *Peele* and petitioner's case was virtually identical. In holding *Wilcox* controlling under such a set of facts, the Court in its fulsome and well reasoned opinion said:

"In support of the defendants' contention that this embezzled money is not taxable to defendant Peelle, *Commissioner of Internal Revenue* v. *Wilcox*, 1946, 327 U.S. 404, 66 S.Ct. 546, 90 L.5d. 752, is cited. The Tax Court has ruled that embezzled money constituted taxable income to the embezzler. The Supreme Court ruled that this was a clear-cut mistake of law.

That decision pointed out (327 U.S. at page 408. 66 S.Ct. at page 549):

> '• • • a taxable gain is conditioned upon (1) the presence of a claim of right to the alleged gain and (2) the absence of a definite, unconditional obligation to repay or return that which would otherwise constitute a gain. Without some bona fide legal or equitable claim, even though it be contingent or contested in nature, the taxpayer cannot be said to have received any gain or profit within the reach of Section 22(a) (26 U.S.C.A. Section 22(a)). • • • Nor can taxable income accrue from the mere receipt of property or money which one is obliged to return or repay to the rightful owner, as in the case of a loan or credit. Taxable income may arise, to be sure, from the use or in connection with the use of such property. Thus if the taxpayer uses the property himself so as to secure a gain or profit therefrom, he may be taxable to that extent. And if the unconditional indebtedness is cancelled or retired taxable income may adhere, under certain circumstances, to the taxpayer. But apart from such factors the bare receipt of property or money wholly belonging to another lacks the essential characteristics of a gain or profit within the meaning of Section 22(a).'
>
> • • •

"The Circuit Court in Appeals for the Second Circuit, in *J. J. Dix, Inc.* v. *Commissioner of Internal Revenue*, 223 F.2d 436, held that funds embezzled by a president of a corporation were not taxable to the president, the embezzler. The facts in that case can be summarized briefly as follows: J. J. Dix was the president who dominated a family corporation. By deceiving his son who was the only other responsible corporate executive he withdrew money from corporate accounts without the consent, coerced or otherwise, of the company and diverted the funds to

his own use. The court held that the fact that he was the president did not amount to corporate consent and that his acts amounted to a simple case of embezzlement. The corporation was taxed for this embezzled money. The court ruled that Dix could not be taxed.

"This *Dix* case, *supra*, follows the *Wilcox* case, *supra*, and distinguishes *Rutkin* v. *United States*, 343 U.S. 130, 72 Ct. 571, 96 L. Ed. 833. In the *Rutkin* case the Supreme Court held that moneys obtained by extortion induced by harassing demands and threats of violence is income taxable to the extortioner.

* * *

"The amounts taken out of these so-called 'secret' bank accounts and embezzled by Henry E. Peelle and converted to his own use and later returned, therefore, are not taxable income."

Finally, we come to the recent decision of Judge Charles E. Wyzanski, Jr. in *United States* v. *Vera Green*, (decided March 31, 1959) in the United States District Court for the District of Massachusetts.

The pertinent facts of the *Green* case, as quoted from the yet unpublished decision of Judge Wyzanski, are:

"At all material times Vera Green was the clerk, secretary and director of Botwinik Brothers of Massachusetts. She owned 40 shares out of the 750 shares which had been authorized and issued. Without any authority from the board of directors and in violation of her duty as an officer, director and employee, she utilized for her personal purposes, or for the purposes of her husband or a corporation in which she was interested, corporate assets belonging to Botwinik Brothers of Massachusetts, Inc. It is quite unnecessary at this stage to recite the form in which these diversions occurred. (AUTHOR'S NOTE: These embezzlements amount to $139,000.00). Some

of them were by way of petty cash vouchers, others by way of accounts payable invoices, and others in other ways. From the facts which have been stipulated it is clear that many of these diversions were subject to prosecution and conviction under the State law of Massachusetts governing larceny and, more particularly, under the provisions which incorporate the old common law crime of embezzlement. In fact, up to now Mrs. Green has not been prosecuted in the state courts for this larceny. It does not appear whether she will hereafter be prosecuted in view of the admissions made in connection with these proceedings."

The ruling of the Court then follows:

"With respect to the joint income tax returns, I am cabined by the decision rendered by the Supreme Court of the United States in *Commissioner* v. *Wilcox*, 327 United States 404 (1946). The Supreme Court of the United States 13 years ago decided that embezzled money does not constitute taxable income to the embezzler under Section 22(a) of the Internal Revenue Code. It makes no difference whether I do or do not agree with that ruling. The Supreme Court has not impaired its authority. Indeed, in refusing to review the decision of the Second Circuit rendered in *J. J. Dix, Inc.* v. *Commissioner*, 223 Federal 2d, 436, it seems as though the Supreme Court of the United States is quite content to leave the *Wilcox* doctrine stand. Moreover, the Congress of the United States has not chosen to alter the doctrine in the *Wilcox* case. It is undeniable that the decision of the Supreme Court was reported to Congressional Committees and that despite this report and despite a recodification and general overhauling of the Internal Revenue Code within the last decade, no legislative alteration in the *Wilcox* doctrine has been made. It would be unseemly for a District Judge, in the light of these circumstances, not to follow the *Wilcox* case,

and it would be particularly undesirable for a single District Judge to create fine distinctions between the *Wilcox* case and the facts of this case, which is a criminal proceeding.

"Needless to say, if the Government feels that distinctions urged before me are of great importance, and should be presented to a bench of several judges, it is possible for the Government to proceed civilly against these defendants, and then if the Government loses in the civil action to take appropriate appeal to bring the matters before higher tribunals

"In all cases it is of importance for the Court not only to act justly but to appear to act justly, and it would appear to many people to be shocking in a criminal case for a single judge to enunciate fine-spun distinctions between that case and what has commonly been regarded as a landmark case in the Supreme Court of the United States.

"The motion is granted in toto. The defendant stands acquitted."

Thus, it is apparent that the decision of the Court of Appeals for the Seventh Circuit to which this petition is directed stands in conflict with decisions of other Circuits and can only add to the confusion now existing in the courts as to the proper application of the rule in *United States v. Wilcox, supra,* and *United States v. Rutkin, supra.*

CONCLUSION.

For the foregoing reasons this petition for writ of certiorari should be granted.

Respectfully submitted,

JOSEPH E. GREEN,
RICHARD E. GORMAN,
Attorneys for Petitioner.

APPENDIX.

IN THE
UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

No. 12719 SEPTEMBER TERM, 1959 SEPTEMBER SESSION, 1959.

UNITED STATES OF AMERICA,
Plaintiff-appellee,
v.
EUGENE C. JAMES,
Defendant-appellant.

Appeal from the United States District Court for the Northern District of Illinois, Eastern Division.

December 29, 1959

Before SCHNACKENBERG and KNOCH, *Circuit Judges*, and PLATT, *District Judge*.

SCHNACKENBERG, *Circuit Judge*. After a trial without a jury, the district court found defendant Eugene C. James guilty of wilfully attempting to defeat and evade a large part of income tax due and owing by him and his wife for each of the years 1951 to 1954 inclusive, as alleged in a four count indictment. From judgment entered on the said findings, defendant has appealed.

The facts are not in dispute. The monies obtained by defendant amounting to over $700,000, which were not included in his returns for the taxable years, were misappropriated by him, partly from a union entity and partly from an insurance company, by means which made him guilty of the crime of embezzlement of such funds as a principal, under applicable laws of New Jersey. Defendant and one Saperstein were indicted for said embezzlement in New Jersey and an order of extradition of defendant from Illinois to New Jersey was affirmed by the

Illinois Supreme Court, *James* v. *Lynch*, 16 Ill. 2d 380 (1959), and a petition for rehearing denied May 19, 1959.

Defendant argues that the receipt of embezzled funds, where the embezzlement has been made the subject of criminal prosecution, and when the fact that the funds were obtained by the crime of embezzlement has been specifically found by the trial court, does not constitute taxable income to the embezzler. He relies on *Commissioner* v. *Wilcox*, 327 U.S. 404 (1946). However, plaintiff contends that, as applied to the facts in this case, the *Wilcox* interpretation of section 22 (a)[1] was rejected by *Rutkin* v. *U.S.*, 343 U.S. 130 (1952). In *Rutkin*, it was held that money obtained by extortion constitutes taxable income to the extortioner. The court applied this test, at 137:

> An unlawful gain, as well as a lawful one, constitutes taxable income when its recipient has such control over it that, as a practical matter, he derives readily realizable economic value from it. *Burnet* v. *Wells*, 289 U.S. 670, 678; *Corliss* v. *Bowers*, 281 U.S. 376, 378. • • •

The court referred, at 138, to *Wilcox* in these words:

> We do not reach in this case the factual situation involved in *Commissioner* v. *Wilcox*, 327 U.S. 404. We limit that case to its facts. There embezzled funds were held not to constitute taxable income to the embezzler under § 22 (a). The issue here is whether money extorted from a victim with his consent induced solely by harassing demands and threats of violence is included in the definition of gross income under § 22 (a). We think the power of Congress to tax these receipts as income under the Sixteenth Amendment is unquestionable. The broad language of § 22 (a) supports the declarations of this Court that Congress in enacting that section exercised its full power to tax income. We therefore conclude that § 22 (a) reaches these receipts.

Three years later, in *Commissioner* v. *Glenshaw Glass Co.* 348 U.S. 426 (1955), the court cited *Rutkin* in support of its holding, at 429-430, that Congress, in enacting sec-

[1] 28 U.S.C.A. (1939 I.R.C.) § 22 (a).

tion 22 (a), "applied no limitations as to the source of taxable receipts, nor restrictive labels as to their nature"; and that it thereby intended "to tax all gains except those specifically exempted", and thus (433), "to bring the taxing power to bear upon all receipts constitutionally taxable • • •."

Again, whereas the *Wilcox* interpretation resorted to *state* law in determining the absence of a bona fide claim of right to the alleged gain and the existence of an obligation to repay it, *Rutkin* made no resort to state law. Instead it recognized the well settled principle that in matters of federal taxation "Congress establishes its own criteria and the state law may control only when the federal taxing act by express language or necessary implication makes its operation dependent upon state law". *Lyeth* v. *Hoey*, 305 U.S. 188, 194 (1938). See also, *United States* v. *Pelzer*, 312 U.S. 399 (1941); *Jerome* v. *United States*, 318 U.S. 101 (1943); *Estate of Putnam* v. *Commissioner*, 324 U.S. 393 (1945). Thus *Rutkin* was an interpretation of section 22 (a) in keeping with precedent, and the economic use and benefit test there announced—unlike the claim of right test of *Wilcox*—provided a rule of law susceptible of ready and uniform application to all unlawful gains, however acquired.

For the reasons herein set forth, the judgment of the district court is affirmed.

AFFIRMED.

UNITED STATES COURT OF APPEALS
For The Seventh Circuit

Chicago 10, Illinois

Tuesday, December 29, 1959

Before

Hon. Elmer J. Schnackenberg, Circuit Judge

Hon. Win G. Knoch, Circuit Judge

Hon. Casper Platt, District Judge

United States of America, *Plaintiff-Appellee,* vs. Eugene C. James, *Defendant-Appellant.*	Appeal from the United States District Court for the Northern District of Illinois, Eastern Division.

No. 12719

This cause came on to be heard on the transcript of the record from the United States District Court for the Northern District of Illinois, Eastern Division, and was argued by counsel.

On consideration whereof, it is ordered and adjudged by this court that the judgment of the said District Court in this cause appealed from be, and the same is hereby Affirmed, in accordance with the opinion of this Court filed this day.

UNITED STATES COURT OF APPEALS

FOR THE SEVENTH CIRCUIT

Chicago 10, Illinois

Monday, February 8, 1960

Hon. Elmer J. Schnackenberg, Circuit Judge

Hon. Win G. Knoch, Circuit Judge

UNITED STATES OF AMERICA,
Plaintiff-Appellee,

No. 12719 vs.

EUGENE C. JAMES,
Defendant-Appellant.

Appeal from the United States District Court for the Northern District of Illinois, Eastern Division.

On consideration of the motion of counsel for defendant-appellant for extension of time in which to file petition for rehearing, and affidavits in support of said motion, counsel for plaintiff-appellee having filed no objections thereto,

IT IS HEREBY ORDERED that the time within which defendant-appellant may file a petition for rehearing in this cause be extended for five (5) days from this date.

UNITED STATES COURT OF APPEALS

FOR THE SEVENTH CIRCUIT

Chicago 10, Illinois

Monday, February 29, 1960

Hon. Elmer J. Schnackenberg, Circuit Judge

Hon. Win G. Knoch, Circuit Judge

Casper Platt, District Judge

UNITED STATES OF AMERICA,
Plaintiff-Appellee,

No. 12719 vs.

EUGENE C. JAMES,
Defendant-Appellant.

Appeal from the United States District Court for the Northern District of Illinois, Eastern Division.

It is ordered by the Court that the petition for a rehearing of this cause be, and the same is hereby, DENIED.

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No. 820 63

In the Supreme Court of the United States

OCTOBER TERM, 1959

EUGENE C. JAMES, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

MEMORANDUM FOR THE UNITED STATES

J. LEE RANKIN,
Solicitor General,

CHARLES K. RICE,
Assistant Attorney General,
Department of Justice,
Washington 25, D. C.

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In the Supreme Court of the United States

OCTOBER TERM, 1959

No. 820

EUGENE C. JAMES, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

MEMORANDUM FOR THE UNITED STATES

After a trial to the court—a jury having been waived—petitioner was convicted of wilfully attempting to evade and defeat the payment of income taxes for the years 1951 through 1954, in violation of Sections 145(b) and 7201 of the Internal Revenue Codes of 1939 and 1954, respectively. The conviction was affirmed by the Court of Appeals (273 F. 2d 5) on December 29, 1959 (Pet. Appendix 1a-4a). On February 8, 1960, the court below granted petitioner leave to file a petition for rehearing out of time.

(Pet. Appendix 5a).[1] A petition for rehearing, filed on February 12, 1960, was denied on February 29, 1960 (Pet. Appendix 6a). The petition for a writ of certiorari was filed on March 26, 1960.

The petition presents a single question: Whether funds which the trial court concluded were embezzled by petitioner nonetheless constitute taxable gains to him in the years in which misappropriated.[2]

In *Commissioner* v. *Wilcox*, 327 U. S. 404, this Court held that funds which the taxpayer had been convicted of embezzling did not constitute taxable income. Six years later, in *Rutkin* v. *United States*, 343 U. S. 130, the Court, ruling that an unlawful gain, as well as a lawful one, constitutes taxable income when its recipient has the actual use and benefit of it, held that money obtained by extortion was taxable gain. In so holding, this Court said of *Wilcox*, (*id.*, p. 138): "We do not reach in this case the factual situation involved in *Commissioner* v. *Wilcox*. * * * We limit that case to its facts." Both courts below, relying on *Rutkin*,[3] held that the funds

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[1] On February 3, 1960, petitioner filed, out of time, a motion in the court below, supported by affidavits, "for an order extending the time for filing a Petition for Rehearing * * * for five (5) days from the time this motion is acted upon". The motion was granted on February 8, 1960 (Pet. Appendix 5a), and the petition for rehearing was filed on February 12, 1960.

[2] The facts—many of which were stipulated—were found specially by the trial court and are not in dispute.

[3] See, also, *Commissioner* v. *Glenshaw Glass Co.*, 348 U. S. 126; *Commissioner* v. *Lo Bue*, 351 U. S. 243; cf. *Commissioner* v. *Jacobson*, 336 U. S. 28.

involved here, although misappropriated, were nonetheless taxable gains falling within the broad sweep of gross income as defined by Congress[4] and interpreted by this Court. They concluded that *Rutkin*, in effect, overruled *Wilcox*.

Petitioner, contending (Pet. 14-28) that *Wilcox* governs, alleges that the decision below is in conflict with that case, with the decision of the Court of Appeals for the Second Circuit in *J. J. Dix, Inc.* v. *Commissioner*, 223 F. 2d 436, certiorari denied, 350 U. S. 894, and with the decisions of the District Courts in *United States* v. *Peelle*, 159 F. Supp. 45 (E.D. N.Y.), and *United States* v. *Green* (D. Mass.), decided March 31, 1959.

We believe that the decision below is correct and that the rule of the *Rutkin* case is applicable to all gains, lawful or otherwise, which the recipient uses and enjoys, whatever the means by which acquired. The several Courts of Appeals which have had occasion to pass on the taxability of unlawful gains of various kinds in the light of *Rutkin* have so applied it,[5] with the exception of *Dix*. We agree that there is a conflict with *Dix*, in which the Court of Appeals for the Second Circuit, in a split decision, reversed

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[4] Sections 22(a) and 61(a) of the Internal Revenue Codes of 1939 and 1954, respectively.

[5] See *Kann* v. *Commissioner*, 210 F. 2d 247 (C. A. 3d), certiorari denied, 347 U. S. 967; *Briggs* v. *United States*, 214 F. 2d 699 (C. A. 4th), certiorari denied, 348 U. S. 864; *Davis* v. *United States*, 226 F. 2d 331 (C. A. 6th), certiorari denied, 350 U. S. 965; *Schira* v. *Commissioner*, 240 F. 2d 672 (C. A. 6th); *Macias* v. *Commissioner*, 255 F. 2d 23 (C. A. 7th); *Prokop* v. *Commissioner*, 254 F. 2d 544 (C. A. 7th); *United States* v. *Wyss*, 239 F. 2d 658 (C. A. 7th);

the Tax Court and held that funds which were diverted by an officer from a corporation were embezzled and were nontaxable receipts under *Wilcox*.[6]

The decision below is also contrary to decisions of the District Courts in *United States* v. *Green*, *supra*; *United States* v. *Peelle*, *supra*; and *United States* v. *Keam* (E.D. Ky.), decided December 10, 1958. The *Green* and *Keam* cases were prosecutions for tax evasion in which judgments of acquittal were granted on the authority of *Wilcox*; the *Peelle* case was a civil proceeding. In both the *Green* and *Peelle* cases, it was held that funds diverted by an officer stockholder from a closely held corporation were embezzled and hence were not taxable gains under *Wilcox*. In *Keam*, it was held that funds which the defendant diverted from a partnership, of which he was an equal partner with his two sons, were embezzled and therefore nontaxable receipts under *Wilcox*. Two other District Court cases express the view that *Wilcox* has continuing vitality. See *United States* v. *Mavroleon* (S.D. N.Y.), decided April 15, 1958 (1 A.F.T.R. 2d 1478), and *United States* v. *Goodman*, 178 F. Supp. 338 (E.D. Va.).

Rollinger v. *United States*, 208 F. 2d 109 (C. A. 8th); *Marienfeld* v. *United States*, 214 F. 2d 632 (C. A. 8th), certiorari denied, 348 U. S. 865; *Berra* v. *United States*, 221 F. 2d 590 (C. A. 8th), affirmed without discussion of this point, 351 U. S. 131; *Hartman* v. *United States*, 245 F. 2d 349 (C. A. 8th); *Smith* v. *United States*, 257 F. 2d 132 (C. A. 10th).

[6] Compare the *Dix* case with the Second Circuit's earlier decision in *United States* v. *Bruswitz*, 219 F. 2d 59, certiorari denied, 349 U.S. 913.

In view of the conflict between the instant case and the Second Circuit's decision in the *Dix* case and the need for settling the status of the *Wilcox* case in the light of subsequent holdings, the Government does not oppose the granting of the writ.

Respectfully submitted,

J. LEE RANKIN,
Solicitor General.

CHARLES K. RICE,
Assistant Attorney General.

APRIL, 1960.

☆ U. S. GOVERNMENT PRINTING OFFICE: 1960 57-7919 1363

IN THE

Supreme Court of the United States

OCTOBER TERM, 1960.

No. 63

EUGENE C. JAMES,

Petitioner,

vs.

UNITED STATES OF AMERICA,

Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit

BRIEF FOR PETITIONER

JOSEPH E. GREEN
RICHARD E. GORMAN
One North LaSalle Street
Chicago, Illinois
Attorneys for Petitioner

The Scheffer Press, Inc.—ANdover 3-6850

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BRIEF FOR PETITIONER.

OPINION BELOW.

The opinion of the Court of Appeals for the Seventh Circuit (R. 19) is reported in 273 F.2d 5.

JURISDICTION.

The judgment of the Court of Appeals for the Seventh Circuit affirming a judgment of the District Court for the Northern District of Illinois (R. 16) was entered on December 29, 1959 (R. 22). A timely petition for rehearing was denied on February 29, 1960 (R. 23). The jurisdiction of this Court is invoked under 28 U.S.C. 1254 (1), 62 Stat. 928. Certiorari was granted on May 16, 1960.

STATUTES INVOLVED.

Internal Revenue Code of 1939:

Sec. 22. GROSS INCOME.

(a) General Definition.—"Gross Income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service * * * of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

(26 U.S.C. 1952 ed., Sec. 22(a).)

SEC. 145. PENALTIES.

* * *

(b) Failure to Collect and Pay Over Tax, or Attempt to Defeat Tax.—Any person required under this chapter to collect, account for, and pay over any tax imposed by this chapter, who willfully fails to collect or truthfully account for any pay over such tax, and any person who willfully attempts in any manner to evade or defeat any tax imposed by this chapter or the payment thereof, shall, in addition to other penalties provided by law, be guilty of a felony and, upon conviction thereof, be fined not more than $10,000 or imprisoned for not more than five years, or both, together with the costs of prosecution.

* * *

(26 U.S.C. 1952 ed., Sec. 145(b).)

Internal Revenue Code of 1954:

SEC. 61. GROSS INCOME DEFINED

(a) General definition.—Except as otherwise provided in this subtitle, gross income means all income from whatever source derived, * * *

* * *

(26 U.S.C. 1952 ed., Supp. IV, Sec. 61(a).)

SEC. 7201. ATTEMPT TO EVADE OR DEFEAT TAX

Any person who wilfully attempts in any manner to evade or defeat any tax imposed by this title or the payment thereof shall, in addition to other penalties provided by law, be guilty of a felony and, upon conviction thereof, shall be fined not more than $10,000, or imprisoned not more than 5 years, or both, together with the costs of prosecution.

(26 U.S.C. 1952 ed., Supp. IV. Sec. 7201.)

QUESTION PRESENTED.

1. Whether the receipt of embezzled funds (where the fact of such embezzlement has been specifically found by the Trial Court and has been made the subject of criminal prosecution) constitutes the receipt of taxable income in the hands of the embezzler.

STATEMENT OF THE CASE.

1. The Indictment.

This prosecution was commenced on December 13, 1957, by the return of an Indictment in four Counts, the first three being under Section 145(b) of the Internal Revenue Code of 1939 (26 U.S.C. 145(b)) and the fourth Count being under the then newly applicable successor, Section 7201 of the Internal Revenue Code of 1954 (26 U.S.C. 7201).

The first Count of the Indictment charged the petitioner with willfully attempting to defeat and evade a large part of the income tax due and owing by him and his wife to the United States for the year 1951 by filing a joint return for that year showing $2,353.44 due, whereas it is alleged that the petitioner knew that there was $70,037.14 owing for his tax liability for that year. The second Count charged the same offense for the year 1952, the return showing $5,997.38 due, whereas it was alleged that the petitioner knew there was due $166,195.67. The third Count related to the year 1953, for which the return showed a tax liability of $3,107.88, whereas it was alleged that the petitioner knew the amount due was $325,323.04. The fourth Count concerned the year 1954 for which the tax liability as reported was $2,962.88, whereas the Indictment alleged the petitioner knew that the amount due was $15,847.90.

2. The Trial.

The cause was tried to the court upon waiver of trial by jury, consented to by the government and approved by the court. (R. 5, 6). At the close of the evidence for the prosecution the petitioner orally moved for a judgment of acquittal, which motion was denied.

At the close of all of the evidence, the petitioner again moved orally for a judgment of acquittal, which motion was again denied. The court then found the petitioner guilty on each Count (R. 16).

3. The Special Findings of Fact.

The court, acting under Rule 23(c) of the Federal Rules of Criminal Procedure, entered most detailed Findings of Fact, specially finding all material facts as disclosed by the evidence and additionally finding ultimate facts and conclusions of law (R. 6 through 16).

Because of the detailed and fulsome Special Findings of Fact entered by the Trial Judge, which appear in their entirety in the Record as above referenced, it is believed unnecessary in this Statement of Facts for this petitioner to do other than here again, for the convenience of this Court, repeat such special findings as the same were made and entered by the Court, as the tryer of the facts (R. 6 through 14).

"Petitioner filed timely joint income tax returns for himself and his wife for the years 1951, 1952, 1953 and 1954 with the District Director of Internal Revenue at Chicago, Illinois.

"The income reported by petitioner on his returns consisted of salary received from the Laundry Workers Union, Local No. 46, located in Chicago, Illinois, salary from the Laundry Workers International Union, whose headquarters were in Indianapolis, Indiana; salary from Local No. 985 of the International Brotherhood of Teamsters, located in Detroit, Michigan; certain payments received as a Welfare Deputy for the aforementioned Local No. 46; certain expense monies received from afore-

mentioned Local No. 46. He also reported net losses from the operation of a racing stable.

"From January 1, 1950 to August 7, 1952, petitioner was seventh Vice President and Acting General Secretary and Treasurer of the Laundry Workers International Union. From August 7, 1952 to December 31, 1954 defendant was General Secretary and Treasurer of the Laundry Workers International Union. In addition, he was Deputy Trustee in charge of Local No. 46 of the Laundry Workers Union from May 13, 1949 until October, 1954, during which period the Local was under a trusteeship. Upon termination of the trusteeship in October, 1954, he became Secretary and Treasurer of the Local.

"Throughout the years 1951 to 1954 inclusive there was in existence a welfare trust known as the Social Security Department of the Laundry Workers International Union. The trust had been created pursuant to a mandate of the 1949 Convention of the Laundry Workers International Union. The Social Security Department was an entity separate and distinct from the Laundry Workers International Union. The purpose of the trust known as the Social Security Department was to provide welfare benefits for union members. The Social Security Department was governed by six trustees, three of whom were selected by Management and three by Labor. At no time was the defendant a trustee or other officer of the Social Security Department.

"Petitioner was appointed Welfare Deputy for Laundry Workers Local No. 46 of Chicago under a written agreement with the Social Security Department executed on October 9, 1960. This agreement provided, among other things, that petitioner was to receive 5 per cent of all premiums payable to the Security Mutual Life Insurance

Company under the latter's contract covering members of Local No. 46, and that expenses incurred by defendant in investigating claims were to be paid by him out of this sum. The agreement between petitioner and the Social Security Department contained the following clause:

> "* * * Should any surplus remain after payment of said items then it may be retained (by petitioner), provided, however, that such surplus shall be reported as income (by petitioner) in accordance with law. * * *"

In his returns for the years in question, petitioner reported as gross income sums allegedly representing the difference between the amounts received and the amounts expended under the agreement.

"The Social Security Department received payments from various employers throughout the country on behalf of union employees, which payments were deposited by the bookkeeper for the Social Security Department in the Indiana National Bank of Indianapolis, Indiana. The receipt of these funds was regularly recorded by the bookkeeper of the Social Security Department.

"From April, 1950 to and including October 1, 1953, the Security Mutual Life Insurance Company of Binghamton, New York, by contract with the Social Security Department of the Laundry Workers International Union, had in effect health and accident insurance policies covering the members of the various laundry workers' local throughout the country. For the period March 1951 to October 1, 1953, premiums on the health and accident policies were paid by the Social Security Department to one Louis B. Saperstein of Newark, New Jersey, an insurance broker and agent for the Security Mutual Life Insurance Company.

"Louis B. Saperstein was the Managing Officer of two insurance brokerage firms known as the Harlew Agency of Illinois, Inc. and the Harlew Agency of California, Inc. All checks for payment of premiums to the Security Mutual Life Insurance Company by the Social Security Department were made payable to Louis B. Saperstein and were deposited by him, or persons employed by him, in bank accounts of either Harlew Agency of Illinois, Inc. or Harlew Agency of California, Inc.

"The funds received by Louis Saperstein from the Social Security Department during the years 1951 to 1953 inclusive were wholly disbursed by him for the following purposes:

(a) Payments to the Security Mutual Life Insurance Company of Binghamton, New York, as premiums on the policies in existence between that company and the Social Security Department for the Laundry Workers International Union;

(b) Payments of claims made by laundry worker employees who, under the terms of the policies, were ineligible to receive benefits from the Security Mutual Life Insurance Company;

(c) By checks drawn to the Order of the Laundry Workers International Union and mailed to the defendant at his residence in Wheaton, Illinois, or at his office in the headquarters of Local No. 46 of the Laundry Workers International Union at 1640 West Van Buren Street, Chicago, Illinois.

"On September 14, 1951, petitioner opened a bank account at the Merchants National Bank, Chicago, Illinois, in the name of the Laundry Workers International Union. This bank account was opened without the author-

ization of the Laundry Workers International Union or the Social Security Department. The signature card for this bank account required only the signature of petitioner to effect withdrawals from the account.

"Petitioner deposited in the above-mentioned Merchants National Bank account all checks received by him from Saperstein which were payable to the Laundry Workers International Union, and which were drawn on accounts of Harlew Agency of Illinois, Inc. and Harlew Agency of California, Inc.

"The funds so received by petitioner and deposited by him in the Merchants National Bank during the years 1951, 1952, 1953 and 1954 amounted to $80,451.35; $175,265.81; $368,367.81, and $29,561.69 respectively.

"*The funds referred to in (the preceding two paragraphs) were under the laws and statutes of the State of New Jersey embezzled by the petitioner, and that under the laws and statutes of such State, the petitioner, James, is guilty of the crime of embezzlement of such funds as a principal, along with Saperstein.* (Emphasis supplied.)

"That Saperstein and the petitioner were jointly indicted for the crime of conspiracy to embezzle and for the crime of embezzlement of the funds in question by the Grand Jurors of Essex County, New Jersey, and that such indictment is now pending in the courts of that state; and the petitioner has been ordered extradited for trial in New Jersey by order of the Circuit Court of Du Page County, Illinois, which order was affirmed by the Supreme Court of Illinois on March 20, 1959; that there is now pending before the Supreme Court of Illinois a petition for rehearing of the aforesaid order of affirmance.

"By letters dated July 17, 1951 and July 27, 1951, petitioner stated to the Security Mutual Life Insurance Company that members of the Laundry Workers International Union were performing services and incurring expenses in connection with the promotion of the welfare plans, and that in his opinion such functions and expenses were properly the burden of the insurance company. Accordingly, he requested that the insurance company consider reimbursing the union for these expenditures. By letter dated September 10, 1951, addressed to petitioner the insurance company agreed to pay the union $2,500.00 a month as reimbursement for such expenses. The agreement was made retroactive to January, 1951. Pursuant to this agreement, one check for $20,000.00, covering the retroactive period, was made payable to the Laundry Workers International Union; one check for $2,500.00 was made payable to E. C. James; the remaining monthly checks in the amount of $2,500.00 each were made payable to E. C. James, Acting Secretary-Treasurer of the Laundry Workers International Union. All of the checks were mailed to petitioner, endorsed by rubber stamp, and deposited by him in the above-mentioned account at the Merchants National Bank. For the years 1951, 1952 and 1953 the sums so received and deposited by the petitioner totaled $30,000.00, $32,500.00 and $22,500.00 respectively. The representations made by the petitioner to the Security Mutual Life Insurance Company in the aforementioned letters, as a result of which the above sums of $2,500.00 a month were paid by the insurance company, were made without authorization of any other officer of the Laundry Workers International Union or any trustee of the Social Security Department.

"That the acts of the petitioner referred to in (the preceding paragraph) constituted the crime of embezzle-

ment of the $85,000.00 therein referred to under the laws and statutes of the State of Illinois. (Emphasis supplied.)

"On numerous occasions during the years 1951 to 1954 inclusive, petitioner visited the Merchants National Bank of Chicago, Illinois, and drew checks on the account maintained by him at this bank in the name of the Laundry Workers International Union. These checks were drawn to the order of E. C. James and were immediately cashed by him at the bank. During the years in question, petitioner received from the above sources (*i.e.*, the Harlew Agencies, Inc. and the Security Mutual Insurance Company) and deposited in the Merchants National Bank the following sums:

1951	$110,451.45
1952	207,765.81
1953	390,867.81
1954	29,561.69
Total	$738,646.66.

By May 6, 1954, petitioner had withdrawn all funds which he had deposited in this account.

"None of the funds in question were paid over by the petitioner to the Laundry Workers International Union or the Social Security Department, and no part of the funds was expended by the petitioner for the benefit of the aforementioned union entities.

"During the years involved petitioner maintained safe deposit boxes at the Gary-Wheaton Bank in Wheaton, Illinois, the town in which he resided, to which safe deposit boxes he made frequent entries. During the year 1951 he made nineteen visits to the boxes; during the year 1952 he made twenty-two visits to the boxes; during

the year 1953 he made nineteen visits to the boxes; during the year 1954 he made ten visits to the boxes.

"Throughout the period in question, petitioner also maintained three checking accounts and one savings account at the Gary-Wheaton Bank at Wheaton, Illinois. In addition, he maintained two checking accounts at the Central National Bank in Chicago, Illinois. Petitioner made cash deposits to his accounts at the Gary-Wheaton Bank in each of the years 1951, 1952, 1953 and 1954 totaling $27,990.00, $51,860.00, $15,200.00, and $14,310.00 respectively.

"In addition to the currency deposits during this time, which exceeded $109,000.00, defendant purchased a horse from Leopha Wilson in November, 1953, for $10,000.00 in currency. This currency was not withdrawn from any of defendant's bank accounts.

"On November 17, 1953 petitioner purchased a cashier's check at the Gary-Wheaton Bank in the amount of $2,500.00. There was no withdrawal of a like amount from any of his bank accounts on this date. However, on this same date he made an entry into his safe deposit box at the Gary-Wheaton Bank. As testified to by Matthew J. Dooley, there was mailed to petitioner on December 28, 1953, $27,000.00 worth of stock in the Founders Syndicate of America, Inc., the certificates of which were made out in dummy names and endorsed in blank. This stock resulted from a purchase by Dooley on behalf of a group, including petitioner, which group, in the presence of Dooley, had agreed to produce the funds to buy the stock.

"An analysis of petitioner's various back accounts does not show the withdrawal of $27,000.00 or the withdrawal of any series of checks which would account for the $27,-

000.00. Petitioner's contribution for the purchase of the stock was by cash not withdrawn from his bank accounts.

"None of the funds withdrawn by petitioner from his several accounts at the Gary-Wheaton Bank and the Central National Bank of Chicago during the years 1951 through 1954 were expended on behalf of the Laundry Workers International Union or the Social Security Department, but instead were expended in part for his personal use and benefit.

"The funds received by the petitioner during the years 1951, 1952, 1953 and 1954, which he deposited in the Merchants National Bank of Chicago, Illinois, and subsequently withdrew therefrom, were within his complete dominion and control, and large portions thereof were actually expended by him for his personal benefit. By the receipt of these funds he derived readily realizable economic value in the year of receipt.

"Petitioner's tax returns for the years in question were prepared on the cash receipts basis by an accountant, Daniel D. Contarsy, from information furnished by the petitioner. Contarsy had no knowledge of the receipt by the petitioner of funds from the Harlew Agencies, Inc. or the Security Mutual Life Insurance Company, and none of such funds were reported by petitioner in his returns for the year 1951 to 1954 inclusive."

Thus, under the facts in this case, the same were recited by the detailed special findings of the trial court, which findings of fact are not here challenged, the entirety of the monies obtained by the petitioner which were not included in his returns for the taxable years in question, were funds which the petitioner obtained by means which caused him to be "guilty of the crime of embezzlement of such funds as a principal".

4. The Conclusions of Law.

In the expression of the Trial Judge's Conclusion as a Matter of Law (R. 14, 15) there is found what constitutes an almost express repudiation of the doctrine of this court laid down by it on February 25, 1946 in *Commissioner of Internal Revenue* v. *Laird Wilcox*, 327 U.S. 404. In this statement of findings the Trial Judge held as a matter of law that:

> "The law is that financial or monetary gain to a taxpayer, whether lawfully or unlawfully acquired, constitutes taxable income to the taxpayer in the year when he has such control over it that, as a practical matter, he derives readily realizable economic value from it. It is immaterial whether the receipt of funds by a taxpayer results from misappropriation, embezzlement, or from other lawful or unlawful acts. The fact that in a subsequent year or years a taxpayer has made restitution of part, or all of funds previously received, is of no significance in determining whether the funds were taxable gains in the year in which they were received or appropriated by him. The precise nature of the criminal activity involved, whether it be embezzlement or other crimes, if any, in acquiring the funds here in dispute is not determinative of, and has no bearing on, the question whether such funds are taxable gains to the defendant. Hence, whether the misappropriation or diversion of funds by the defendant constituted, or may be regarded as constituting, the crime of embezzlement, or larceny, or grand theft, or obtaining money by false pretenses, or some other crime or crimes under the applicable state laws is a matter neither relevant nor material to the issues here presented."

5. The Sentence.

Upon the judgment of the Trial Court so finding the petitioner guilty on all counts as charged, the petitioner was committed to the custody of the Attorney General for imprisonment for a period of one year on Count 1 and for a period of two years on Counts 2, 3 and 4 of the Indictment, the sentences imposed on Counts 2, 3 and 4 being ordered to run concurrently with each other, but consecutively to the sentence imposed on Count 1 (R. 17), thus resulting in a three year sentence for the petitioner.

SUMMARY OF ARGUMENT.

The instant case presents for the determination of this Court the single question of whether funds obtained by means of the actual and specially found crime of embezzlement constitute taxable income in the hands of the embezzler, a result which was specifically negated by this Court in *Commissioner* v. *Wilcox,* 327 U.S. 404, a decision of this Court which was not disturbed, as has so often been incorrectly argued, by the subsequent opinion in *Rutkin* v. *United States,* 343 U.S. 130, but which, on the contrary, was explicitly reaffirmed in *Rutkin,* as well as being again thereafter directly approved in law and rationale in *Alison* v. *United States,* 344 U.S. 167 (1952), wherein the peculiar nature of the crime of embezzlement was noted by this Court.

In *Wilcox* it was pointed out that a taxability was conditioned upon (1) a claim of right to the funds obtained, and (2) the absence of a definite and unconditioned obligation to repay. Both of these factors are lacking where monies are obtained by embezzlement, similarly as to where monies are obtained by loan.

Until the decision of the Seventh Circuit here on certiorari, no reported case has treated *Wilcox* as overruled, but all have applied its doctrine in similar factual situations.

Congress, having power to determine taxability, nevertheless left the rule of *Wilcox* undisturbed in its complete overhaul of the Internal Revenue Code in 1954.

Since no *gain* is realized by an embezzler in his obtaining possession of embezzled funds, no tax liability attaches thereto.

ARGUMENT.

1. The Wilcox Case and its Background.

The question of whether embezzled funds were taxable was until 1946 unresolved by authoritative decision of this Court. The taxability of such monies until this time was, however, generally affirmed by various decisions of the Tax Court (*Spruance* v. *Commissioner of Internal Revenue*, 43 BTA(f) 221; *Kurrle* v. *Commissioner of Internal Revenue*, Prentice-Hall, 1941, BTA Mem. Dec. Par. 41,085) as well as by the Administrative rulings of the Department of Internal Revenue (General Counsel's Mem. 16572, XV-1 Cum. Bull. 82 (1936)).

Among the Circuits themselves, no unanimity existed. The Eighth Circuit, by its decision in *Kurrle* v. *Helvering*, 126 F.2d 723 (March 14, 1942), in affirming an order of the Board of Tax Appeals taxing an embezzler from an Iowa bank upon the proceeds of his embezzlement and the profits earned by the use of such funds, had held that, although the embezzler was a trustee *ex maleficio*, "embezzled funds and profits earned by the embezzler through the use of such funds constitute taxable income". In the Fifth Circuit, however, less than two months after the *Kurrle* case a diametrically contrary view was adopted in the case of *McKnight* v. *Commissioner of Internal Revenue*, 127 F.2d 572, (April 29, 1942). In order to resolve this conflict, this Court granted the Government's application for certiorari from a decision of the Ninth Circuit (*Wilcox* v. *Commissioner of Internal Revenue*, 148 F.2d 933, (March 30, 1945) wherein the *McKnight* case's reasoning had been sanctioned, thus giving rise to what is *the first*,

the last and the only direct expression of this Court on the taxability of embezzled funds.

This, of course, is the now classic and "landmark" case of *Commissioner of Internal Revenue* v. *Laird Wilcox*, 327 U.S. 404-416, handed down by this Court on February 25, 1946. In *Wilcox* the taxpayer, a bookkeeper for a transfer and warehouse company in Reno, Nevada, had over a five year period from 1939 through 1942 diverted miscellaneous sums of money belonging to his principal, pocketing them, and thereafter losing practically all of his ill-gotten gains in various gambling houses in Reno. His improper takings during the calendar year of 1941 amounted to $12,748.60. His acts constituted criminal embezzlement under the laws of Nevada, and for this crime he was indicted and convicted in the courts of that state in 1942, and sentenced to serve from 2 to 4 years in prison, from which he was paroled in 1943. The Commissioner determined that the taxpayer was required to report the $12,748.60 which he embezzled during 1941 and in this determination was sustained by the Tax Court. After the reversal of the Tax Court by the decision of the Ninth Circuit above referenced, certiorari was here granted "because of a conflict among circuits as to the taxability of *embezzled money*". (Emphasis supplied).

The Government argued (as it has here below) that taxability rested "upon the enjoyment by the taxpayer of privileges and benefits so substantial and important as to make it reasonable and just to deal with him as if he were the owner, and to tax him on that basis." To this argument this Court said "We cannot agree," continuing:

> "Taxable gain is conditioned upon (1) the presence of a claim of right to the alleged gain and (2) the absence of a definite, unconditional obligation to repay

or return that which would otherwise constitute a gain. Without some bona fide legal or equitable claim, even though it be contingent or contested in nature, the taxpayer cannot be said to have reached any gain or profit within the reach of Section 22(a). See *North American Oil Consolidated* v. *Burnett*, 286 U.S. 417, 424, 76 L.ed. 1197, 1200. Nor can taxable income accrue from the mere receipt of property or money which one is obligated to return or repay to the rightful owner, as in the case of a loan or credit."

* * *

"We fail to perceive any reason for applying different principles to a situation where one embezzles or steals money from another. Moral turpitude is not a touchstone of taxability. The question, rather, is whether a taxpayer received a statutory gain, profit or benefit. That the taxpayer's motive may have been reprehensible or the mode of receipt illegal has no bearing upon the application of Section 22(a).

"It is obvious that the taxpayer in this instance in embezzling the $12,748.60, received the money without any semblance of a bona fide claim of right. And he was at all times under an unqualified duty and obligation to repay the money to this employer. Under Nevada law, the crime of embezzlement was complete whenever an appropriation was made; the employer was entitled to replevy the money as soon as it was appropriated or to have it summarily restored by a magistrate. The employer, moreover, at all times held the taxpayer liable to return the full amount. The debtor-creditor relationship was definite and unconditional. All right, title, and interest in the money rested with the employer. The taxpayer thus received no taxable income from the embezzlement.

"This conclusion is unaltered by the fact that the taxpayer subsequently dissipated all of the embezzled funds in gambling houses. The loss or dissipation of money cannot create taxable income here any more than the insolvency or bankruptcy of an ordinary

borrower causes the loans to be treated as taxable income to the borrower."

"Sanctioning a tax under the circumstances before us would serve only to give the United States an unjustified preference as to part of the money which rightfully and completely belongs to the taxpayer's employer.

"*The Tax Court's determination that the embezzled money constituted taxable income to the embezzler, a result in accord with its prior decisions on the issue, involved a clear-cut mistake of law.* The court below was, therefore, justified in reversing that judgment." (Emphasis supplied.)

In the decision of the *Wilcox* case, seven Justices joined, no part being taken by Mr. Justice Jackson, and Mr. Justice Burton dissenting.

Subsequent to *Wilcox*, the Internal Revenue Service itself in General Counsel's Memo. 24945, Cum. Bull. 1946—2, 27, reversed its prior position regarding the taxability of embezzled funds such as in the *Wilcox* case and recognized them *not* to be taxable.

From the position enunciated in this General Counsel's Memorandum, the Internal Revenue Service has never retreated, and this Memorandum is in full force and effect today.

It is to be noted that *Wilcox* did not hold, as has heretofore in some cases been incorrectly argued on behalf of various taxpayers, that the illegality of the means by which the funds were obtained thereby rendered them non-taxable. This is clearly not now and has never been the law. Unlawful *gains*, where the same are realized under a claim of right and without a definite and unconditional obligation to repay, are taxable equally with law-

ful *gains*, and such state of the law was not disturbed by *Wilcox*. The sole question authoritatively and finally determined by *Wilcox* was the express recognition of the non-taxability of monies obtained wrongfully—without claim of right—when the obtention of such monies created a definite and unconditional obligation to return the same. In short, *Wilcox* declared that monies obtained by embezzlement are simply not *gains*.

After the decision in the *Wilcox* case and the following General Counsel's Memo referenced above, no question as to the non-taxability of funds so obtained seems to have been raised in reported decisions until 1952.

2. The Rutkin Case and its effect upon the Law.

However, on March 24, 1952, this Court, by a sharply divided bench, (5 to 4) handed down the decision in the case of *Rutkin* v. *United States of America*, 343 U.S. 130, 96 L.ed. 833, 72 Sup. Ct. 571, holding money obtained by extortion to be taxable. The petitioner in the case at bar wishes to here and now state that with the *Rutkin* holding, he has no quarrel. Indeed, it is not felt that Rutkin in any way altered the law as it had been prior to *Wilcox* nor did it in any way change or obliterate in any part whatsoever the rule of *Wilcox*. Unfortunately, however, it must be acknowledged that *Rutkin* has formed the basis for much dicta, as will be hereinafter seen, which is to the effect that the rule of *Wilcox* was in some way diluted or modified by *Rutkin*, and it was upon *Rutkin* that the decision below was clearly bottomed. However, the petitioner believes that the actual effect of *Rutkin* was merely to prevent an extension of *Wilcox's* doctrine into areas of taxability in which the law was already clear in affirming that gains were taxable. (See *Humphries* v. *Commis-*

sioner, 125 F.2d 340, wherein extortion or kidnap proceeds had previously to *Rutkin* been held taxable and in which certiorari was denied in 317 U.S. 637, 87 L.ed. 513, 63 Sup. Ct. 28). *Rutkin* did not alter *Wilcox's* holding or destroy its rationale.

It is important here to closely analyze the facts in *Rutkin*. Rutkin was here indicted for willful failure to include in his tax return for 1943, $250,000.00 which he had received during that year from one Joseph Reinfeld. The circumstances of the receipt of the funds were complex. Reinfeld had been engaged in 1929 with the defendant in a bootlegging operation known as the "High seas venture". The defendant was taken into the enterprise because of fear that he or his associates would otherwise create trouble, and was given a 6% interest in the venture for which he appears to have been paid. In 1933 (upon repeal of prohibition) Browne Vintners Co., a New York corporation, was organized to engage in the liquor business by Reinfeld and others. Rutkin was not included in this new venture, but thereafter asserted a claim of a 6% interest in this enterprise as well. In 1940 all of the stock of Browne Vintners was sold for $7,500,000.00 to a purchaser who also assumed $8,000,000.00 of the company's debts, but no money was then paid to Rutkin who was not a stockholder of record, nor a beneficial owner of any of the company's stock but who was nevertheless actively claiming and asserting an interest therein. Thereafter repeated demands were asserted by Rutkin upon Reinfeld for sums ranging up to $500,000.00, Rutkin "threatening use of a gun" and to "kill Reinfeld and Reinfeld's family unless his demands were met." Finally, in 1943, Reinfeld paid Rutkin the $250,000.00 in question, and *Rutkin thereupon signed and Reinfeld received a general release purporting to release Reinfeld, Browne Vintners Company and others from all claims of Rutkin.*

It is to be noted that this Court (page 134 of the Official Reports) pointed out in describing the demands of Rutkin:

> "Throughout this melodrama petitioner (Rutkin) asserted he was entitled to the payments he demanded from Reinfeld because of petitioner's former interest in Browne Vintners Company."

Thus, clearly, Rutkin received the money under a definite "claim of right". It is of no consequence that such claim was in fact invalid, and was not given credence by Reinfeld. The term "claim of right" means what the expression implies—a claim of right—not an actual right. Such a claim of right was the basis upon which Rutkin demanded the money, then received the same, and for which he ultimately executed his written release. In the opinion below (*Rutkin* v. *United States*, 189 F.2d 431) the court applied the "claim of right" doctrine by holding that the extortioner received the money with a "semblance of a bona fide claim of right", since Reinfeld never denied the presence of a claim of right by him for some money, and the extortioner, when asking his victim for money, called it "my money", and gave a general release at the time he was given the money. As pointed out below "Reinfeld has unmistakably considered the $250,000 to be Rutkin's property. He left Rutkin in undisputed possession of it for the last eight years."

This Court declared such money, so obtained to be taxable. In its opinion, after recognizing that Rutkin's "control over the cash so received was such that, in the absence of Reinfeld's *unlikely repudiation* of the transaction and demand for the moneys' return, petitioner could enjoy its use as fully as though his title to it were unassailable", (emphasis supplied) and pointing out that unlawfully obtained income is taxable similarly to lawful gains, the Court said:

"There is little doubt now that where unlawful gains are secured by the fraud of the taxpayer they are taxable. In the instant case it is not questioned that the $250,000 would have been taxable to petitioner if he had obtained it by fraudulently inducing Reinfeld to believe petitioner's false claims to be true. That being so, it would be an extraordinary result to hold here that petitioner is to be tax free because his fraud was so transparent that it did not mislead his victim and his victim paid him the money because of fear instead of fraud.

"We do not reach in this case the factual situation involved in *Commissioner* v. *Wilcox*, 327 U.S. 404, 90 L.ed. 752, 66 S. Ct. 546, 166 ALR 884. We limit that case to its facts. There embezzled funds were held not to constitute taxable income to the embezzler under Section 22(a). The issue here is whether money extorted from a victim with his consent induced solely by harassing demands and threats of violence is included in the definition of gross income under Section 22(a)."

Clearly, it would seem, *Rutkin* does not overrule *Wilcox*. Indeed, quite on the contrary, it reaffirms *Wilcox*. *Rutkin* simply recognizes that the same factual situation as in *Wilcox* did not there pertain. The salient facts present in *Wilcox* (and in the *James* case at bar) which are at variance with *Rutkin*, can be best summarized:

	In James and Wilcox	In Rutkin
Was there an embezzlement?	Yes	No
Was there a "claim of right"?	No	Yes
Was there a "likely repudiation or demand for return"?	Yes	No
Did legal title to the money pass?	No	Yes.

Very simply, *Rutkin* was an extortion—not an embezzlement case. Rutkin got the money claiming that he was entitled to it, (although such claim was not valid, and the real reason for payment was fear of physical violence induced in the payor). Neither James nor Wilcox claimed any right to the funds thus received. Rutkin got good legal title to the money, and, most significantly, as pointed out by this Court, it was, as a practical matter, extremely unlikely that Reinfeld, who paid because of fear, would thereafter repudiate his deal and seek the recovery of the funds. Neither Wilcox nor James, however, at any time obtained legal title to the money of which they took possession. The rightful owner of the same could (and in fact, in the case of *James* actually did) pursue the same. In the *James* case, as in *McKnight* v. *Commissioner of Internal Revenue, supra,* "the takings were large, and under a system of bookkeeping that made discovery and the demand for recovery eventually certain." (See 127 F.2d at page 574). *Rutkin,* on the contrary, obtained clear legal title to the funds, could and did use them as his own, and never at any time had occasion to fear or anticipate that any person whomsoever would challenge his title to the same. The money in short was as a practical matter his. The money taken by James and by Wilcox was not theirs, and hence did not constitute a *gain.*

It is to be observed that the two mandatory indicia of taxability established in *Wilcox i.e.* (1) claim of right to the gain and (2) absence of a definite, unconditional obligation to repay still applied after *Rutkin.* In the *Rutkin* case there was both a claim of right, and, in view of the circumstances of the extortion, there was a practical absence of a definite unconditional obligation to repay.

3. Affirmation of Wilcox in Alison.

An even more forceful demonstration of the continued vitality of the *Wilcox* holding is the case of *Alison* v. *United States*, 344 U.S. 167 (1952), decided by this Court several months after the *Rutkin* decision. The taxpayer there claimed a deduction in a current year on the ground that prior embezzlement by an agent had but recently been discovered. The issue was whether such a deduction should be allowed or whether the taxpayer's only opportunity to claim it occurred in the year when the embezzlement took place. This Court pointed out that the Commissioner frequently allows such current deductions "to prevent hardships and injustice," and stated:

> "This Treasury practice evidently stems at least in part *from the special nature of the crime of embezzlement.* Its essence is secrecy. Taxpayers are usually well aware of all the circumstances of financial losses for which tax deductions are allowed. Not so when a trusted advisor or employee steals. For years his crime may be known only to himself. *He may take money planning to return it and he may return it before there is discovery.* Furthermore, the terms embezzlement and loss are not synonymous. The theft occurs, but whether there is a loss may remain uncertain. One whose funds have been embezzled may pursue the wrongdoer and recover his property wholly or in part. See *Commissioner* v. *Wilcox*, 327 U.S. 404. Events in the *Alison* case show *the practical value of this right of recovery.* A substantial proportion of the embezzled funds was recovered in 1941, ten years after the first embezzlement occurred. This recovery alone is ample refutation of the view that a loss is inevitably 'sustained' at the very time an embezzlement is committed." (Emphasis supplied)

This language compares significantly with the following from the *Rutkin* decision, *supra*, at pp. 136-137:

> "Petitioner's control over the cash so received was such that, in the absence of Reinfeld's *unlikely repudiation of the transaction and demand for the money's return*, petitioner could enjoy its use as fully as though his title to it were unassailable." (Emphasis supplied)

In *Alison*, this Court was not confronted with competing theories of taxability, but rather with examining closely the practical as well as the legal effects of the embezzlement transaction. The opinion emphasizes, and turns upon, "*the practical value of this right of recovery*" possessed by the victim. In economic effect (as opposed to moral import) embezzlement thus closely resembles borrowing, and is markedly different from larceny, robbery, burglary, extortion, unlawful business activities, and other like forms of illegal activity. In these latter, there is no practically valuable right of recovery; in the unlawful business cases, there is usually no unconditional right of recovery; and in all of them, there is no societal pattern of the money being returned before or after detection, nor of the transaction subsequently being amended and characterized by the parties as a loan or advance. It may well be that the extortionist realizes a taxable gain for the reason that, although the victim possesses a right of recovery, this right exists only on a theoretical and non-practical level; if the victim is frightened enough to hand over the money, he will probably remain frightened enough to forbear seeking its return. But the same thing *cannot* be said of embezzlement from an employer where, as every judge and lawyer knows, restitution is commonplace.

4. Decisions of Lower Courts.

It is believed by the petitioner that the decision of the Court of Appeals for the Seventh Circuit here on certiorari constitutes the only pronouncement of any lower court in which the rule of *Wilcox* has not been observed. These cases will be reviewed in this brief for the purpose of demonstrating how the rationale of the *Wilcox* v. *Rutkin* distinctions heretofore argued has been recognized and expanded upon by lower courts.

a. Decisions of lower Courts distinguishing Wilcox on basis of Rutkin.

Although in no reported case whatsoever, decided by any court, save in *James*, has *Wilcox* been overruled, and although all cases recognize in varying degrees the rule of Wilcox, parts of the language of the decision in *Rutkin* has, from time to time, been relied upon in the opinions of lower courts as the basis for distinctions drawn from the *Wilcox* case. As a result, it has been sometimes said that *Rutkin* "diluted" or emasculated" *Wilcox*. It is believed that an analysis of the cases will disclose, however, that such is not the case. *Rutkin* merely *limited Wilcox* to its facts and prevented the extension of its doctrine into other fields of taxability. We shall now proceed to consider and review, in their chronological sequence, the several cases in which *Wilcox* has been distinguished and in which gains of various types and characters have been held taxable.

As a word of introduction to these cases, it is suggested that after *Wilcox* it became fashionable for counsel representing taxpayers to seize upon the *Wilcox* case, regardless of whether or not their clients had or had not obtained the gains in question under a *claim* of right, regardless as

to whether or not their clients were under a real or only a fancied "obligation to return", and regardless as to whether or not an embezzlement prosecution was likely or even possible, and contend themselves to be under *Wilcox*. In cases where embezzlement prosecutions were never possible or contemplated—in cases where the taxpayer had clearly obtained good legal title to his gains and had invested the same for this profit as his own money—in cases where the embezzlement defense as patently an afterthought, the same never having been even raised or considered upon trial—visionary and resourceful defense counsel, nevertheless, girded themselves with *Wilcox's* language.

All manner of swindlers, extortioners, bribees, panders, mountebanks and miscellaneous scalawags, suddenly found themselves, by dint of far fetched and unlikely theories, transformed into alleged "embezzlers." This entirely natural and concomitant result of the *Wilcox* case kept courts busily engaged in pointing out to taxpayers, in effect, that their self-claimed "embezzlements" existed only in the fancy of their own lawyers, and that no embezzlement prosecution had been undertaken or was likely. In the case at bar, it goes without saying, that the embezzlement is not a theory developed by the petitioner's own counsel, but, much to the contrary, was specifically found by the court as a special finding of fact and, in the greater part, is the subject of a real and existing indictment for such crime now pending in the courts of the State of New Jersey, and concerning which indictment the Supreme Court of Illinois, on March 20, 1959, affirmed the order of the Circuit Court of DuPage County, Illinois, extraditing the petitioner to Essex County, New Jersey for trial on indictments charging embezzlement and conspiracy to em-

bezle. (*James* v. *Lynch*, 16 Ill. 2d 380 (1959), Petition for rehearing denied May 19, 1959)

We now proceed to a chronological consideration of opinions of lower courts distinguishing *Wilcox* on its facts:

In *Rollinger* v. *United States*, 208 F.2d 109 (8th CA) (1953) an Iowa farmer practiced a confidence game on one Mrs. Clara B. Mieras, obtaining certains gains as profits by selling her zircons instead of diamonds and obtaining further gains by falsely representing that he needed money to pay as protection or bribes to the F.B.I., which the defendant claimed was investigating stolen diamonds, and to others as "hush money".

After his conviction, the defendant sought to wrench himself under the *Wilcox* case, as well as raising certain other defenses equally of no basis. The Eighth Circuit, on page 112, lost little time in properly disposing of the *Wilcox* contention:

> "Defendant contends that although he may have received large sums of money as a result of these fraudulent threats and misrepresentations, the funds so acquired by him were in the nature of embezzled funds. He relies strongly on the case of *Commissioner* v. *Wilcox* (Citation). In that case it was stipulated that the funds were in fact embezzled. The funds here were acquired either as profits on sales or as funds acquired by fraud, misrepresentation, or extortion."

In short, Rollinger's contention that he was under *Wilcox* did not even approach correctness. He got good legal title to the monies obtained, he asserted a "claim of right" to them, and he was simply not an embezzler, and no one had ever suggested he was—except his own attorney. Nor was there any likelihood that he would have been required to account for the monies so extorted and swindled.

In *Briggs* v. *United States*, 214 F.2d 699 (4th CA) (1954) one defendant, Clark, a property superintendent for the Carolina Aluminum Company and the other defendant, Briggs, operated for several years under an agreement whereunder Briggs secured purchasers to whom lands of the corporation would be sold at prices exceeding those reported to the corporation. They divided the excess between themselves, and paid no tax on the same, using the proceeds as their own money. Their fraud was not discovered until after their indictment for violation of the Internal Revenue Laws.

In striking down the contention that the case fell under *Wilcox*, the decision refused to go into the embezzlement claim, saying:

> "We think it perfectly clear that through the fraudulent transactions in which they were engaged they received moneys over which they had complete control, which they treated as part of their estates, which resulted in economic value to them *and for which they probably never would have been required to account, had it not been for the fraud on the revenue they were perpetrating in connection therewith.*"

It is to be observed that no embezzlement prosecution here took place or was contemplated. Indeed, the deal was such that both men simply realized a secret profit. The Court of Appeals in its decision took particular care to comment approvingly on the following language of the trial judge:

> "* * * I can't believe there is any belief on their part that any part of it (the money) belonged to the company or that it had any claim on it, and they used it for six or seven or eight years; and it was not until after the company jumped them after this indictment that they took the position that they were possibly guilty of embezzlement."

That James knew who was the owner of the money is clear. That he used any part of it as his own was unproven. That he asserted any claim or right is false. That he was "jumped" by the rightful owners is the fact in evidence, and is a result that must have been obvious to him at all times. The embezzlement in the *James* case is not a position taken by the petitioner after his indictment. It is, rather, a position taken by the Grand Jurors of Essex County, and one which, to James' concern, is being now strongly and vigorously asserted by the prosecutor of that jurisdiction, and that he obtained the funds in question by means of the crime of embezzlement is a fact which was specifically, consciously and deliberately found by the District Court.

In *Kann* v. *Commissioner of Internal Revenue*, 210 F.2d 247 (3rd CA) (1954), the defendants were brothers and during all the years in question both were shareholders and directors of three corporations and were the principal owners thereof. From 1936 through 1941, through checks and overstated credits in the personal accounts of the brothers, they concealed payments to themselves in the amount of $675,881.76. In litigation before the Tax Court they contended the assessment of income taxes and fraud penalties were invalid on the ground that these sums had been embezzled and did not constitute income under Section 22(a) of the Internal Revenue Code and cited the *Wilcox* case in support of their position. The Court in its opinion stated first that:

> "In the first place, although taxpayers here strenuously urge that the Kanns embezzled the money *there is not, as the court below emphasized, any external evidence of that crime. They were never indicted or convicted of the alleged embezzlement, nor does it appear that those concerned with the corporate affairs*

of (the corporations) or anyone else, ever urged prosecution. • • • The important distinctions between the *Wilcox* case and this appeal, however, concern the relationship of the taxpayers to their employers. As noted, whereas Wilcox was merely a salaried employee, the Kanns controlled both corporations." (Emphasis supplied).

In a vigorous dissent, Judge Kalodner pointed out:

"The plain import of the majority's position is that it construed *Commissioner* v. *Wilcox* to have been overruled by *Rutkin* v. *United States*, although it paid lip service to *Wilcox* in attempting to distinguish its factual situation from that in the instant cases.

"First, as to whether Rutkin overruled Wilcox:

"I don't believe it did. Nor do I believe that the majority has the right to assume that it did. Like John Alden, the Supreme Court of the United States can and should speak for itself. *Wilcox* held in the plainest terms that embezzled money does not constitute taxable income to the embezzler. Until the Supreme Court tells us otherwise, we are required to follow *Wilcox* in embezzlement cases. It hasn't told us anything different since *Wilcox*. It is true that in *Rutkin* it distinguished between embezzled money and extorted money and held the latter to be taxable income. That circumstances is no reason why an inferior court should assume that *Wilcox* was overruled. Had the Supreme Court intended in *Rutkin* to overruled *Wilcox* it could, and undoubtedly would have said so. But the fact is that it did not and while it limited *Wilcox* 'to its facts' it reiterated its holding in that case that 'there embezzled funds were held not to constitute taxable income to the embezzler under Section 22(a).'"

In commenting on the *Kann* decision, it must be again pointed out that in attempting to escape from *Wilcox*, the

Court here bottomed its rationale on the fact that the defendants controlled the corporations from which the funds were taken *and that their prosecution for embezzlement was unlikely.* Sugh, we again repeat, is not the case with *James. Kann* is simply a case where "embezzlement" was the result of defense counsels' ingenuity—and was not an offense such as upon which prosecution was likely or pursuit of the funds probable. It is here, with the *Kann* case, that we first find a tacit acknowledgment by some of the courts that purely theoretical and technical "embezzlements" will not be treated as real embezzlements which have been made the subject of prosecution. It is here first said in a case distinguishing Wilcox: "They were never indicted or convicted". This languge will in later cases increasingly occur, indicating that some courts (though far from all) have imposed an added qualification for non-taxability of wrongfully obtained money taken under no claim of right, and where a real obligation to repay exists; that is, that there should be an embezzlement prosecution threatened or actual. But even if such an added qualification does exist, the petitioner falls within it.

In *Marienfeld* v. *United States,* 214 F2d 632 (8th CA) (1954), the taxpayer had an agreement with a meat packer whereunder he had authority to sell certain meat products on the packer's behalf and was required to account for the proceeds of sales at intervals. However, he converted the proceeds of some sales to his own use, failing to account for sales or accounting for sales of products, some of which he processed, at a price lower than the sale price. He failed to report or pay tax on such conversions and was indicted and convicted for violation of the Revenue Laws.

The Eighth Circuit frankly indicated it was unable to reconcile *Rutkin* with *Wilcox*, but after giving lip service to both cases, then approached the problem on the basis of which case came closer to the facts at issue. The Court pointed out that this case differed from *Wilcox* in that here the relationship of the parties was such that the obligation to repay was not immediate, but that it was in *Wilcox*, and stressed the fact that here, as in *Rutkin*, the defendants' "control over the cash so received was such that, in the absence of (the payor's) *unlikely repudiation of the transaction and demand for the moneys'* return, petitioner could enjoy its use as fully as though his title to it were unassailable."

In *James*, unlike *Marienfeld*, the obligation to repay was not deferred, but was immediate, as in the case of *Wilcox*. Likewise, in *James*, unlike *Marienfeld*, there was a likely repudiation and demand. In fact, the evidence shows such occurred. Again, and most importantly, in *James*, like *Wilcox*, but unlike *Rutkin* and *Marienfeld*, the embezzlement was made the subject of prosecution, real and existing, and was not merely a theory designed to escape a tax obligation.

In *United States* v. *Bruswitz*, 219 F.2d 59 (2d CA) (1955), the defendants were convicted for the fraudulent failure to report as taxable income the proceeds of commercial bribes or "kick-backs" received in 1949, 1950, and 1951. Their reliance upon the *Wilcox* case upon appeal failed, the court distinguishing the cases on their facts, saying:

> "* * * There a bookkeeper embezzled funds from his employer which he thereafter lost by gambling. The Supreme Court held that these funds were not income within Section 22(a) because of the embezzler's con-

tinuing obligation to restore these funds to his employer—a liability which would have been subordinated to a government lien had the tax been found appropriate. The situation here is quite different. The N.Y. Penal Law distinguishes between embezzlement and commercial bribes, only the former requiring the actual taking or withholding of money or property from the true owner. Compare N.Y. Penal Law Sections 1290 and 439. McK. Consol. Laws, c. 88. That distinction is particularly relevant to the facts before us, since there is no indication that the kickbacks resulted in any loss to defendant's employers."

Although the case is clearly distinguishable on its facts from the *Wilcox* decision, as pointed out by the Second Circuit, the case is here cited, anticipatorily, since the same may be relied upon by the respondent because of the dicta contained in the decision to the effect that "it is difficult to perceive what, if anything, is left of the *Wilcox* holding after *Rutkin*". For the respondent to place weight upon such expressions in *Bruswitz* would be error, since the same Court of Appeals (2d CA) and two of the same Judges (Frank and Medina) who participated in *Bruswitz*, did thereafter in *J. J. Dix* v. *Commissioner of Internal Revenue*, 223 F.2d 436, considered *post*, expressly reaffirm the vitality of *Wilcox* and limited their decision in *Bruswitz* to its facts. Thus, if it can be said that *dictum* can be overruled, such was done in *Dix*.

In *Berra* v. *United States*, 221 F.2d 590 (8th CA), (1955), we find a "kick-back" case in which the taxpayer was the business manager of a labor welfare organization who arranged with a painting contractor to overstate his bills and finally received the amounts of the overpayments from the contractor. The Court held these amounts to

constitute taxable income, despite the defendant's reliance upon the *Wilcox* doctrine, saying:

> "We do not think the facts in the present case bring it within the scope of the *Wilcox* decision. The prosecution proved and the appellant admitted that the money he received came, not from his employer, Labor Health Institute, but from Schmidt. That this was not a case of embezzlement was recognized by the trial court * * * the court pointing out that embezzled funds must be received in the course of employment, which was not so here."

The case is obviously distinguishable in that the claim of an embezzlement in *Berra* was almost frivolous. Schmidt, the contractor who kicked-back the funds to Berra, was never in the employ or agency of any person whomsoever, unlike Saperstein and James, who were both agents of the Union, and Saperstein who was agent of the Security Mutual Life Insurance Company as well.

In *Drybrough* v. *Commissioner of Internal Revenue*, 238 F.2d 735 (6th CA), (1956), two individuals who owned or controlled all stock of a corporation, cashed checks payable to a corporation and divided and kept the proceeds in order to avoid payment by the corporation of a 95 percent excess profits tax. They contended these funds were embezzled under the rule of *Wilcox*, and no tax was therefore due.

This contention was dismissed by the Court of Appeals for the Sixth Circuit in an opinion, interesting insofar as the same, although questioning "how much vitality continues to reside in the *Wilcox* rule since the Supreme Court decision in *Rutkin*", proceeds to then reaffirm the "claim of right" doctrine, as the basis of its decision in saying:

> "We think the Tax Court was clearly correct in concluding that the petitioners took the corporation's funds under a claim of right and with the implied consent of the corporation."

The case is additionally worthy of comment as being exemplary of the lengths to which defendants, utterly outside of the *Wilcox* rule, have attempted to avail themselves of its provisions. Here, there was obviously a taking under a claim of right. There was no conceivable likelihood whatsoever of any demand for a return of the monies so taken from the wholly owned corporation, and there was no envisionable possibility of any embezzlement prosecution.

In *United States* v. *Wyss*, 239 F.2d 658 (7th CA), (1957), we have another "kick-back" case in which the defendant received about $20,000.00 for having procured contracts with the City of Fort Wayne, treating the money as his own by investing it and keeping the returns on the investment. It was admitted that he intended to and did exercise personal dominion over the funds for his own benefit. On appeal, for the first time, it was argued that these funds were not his in law and were subject to recovery by the City of Fort Wayne or, in the alternative, they were embezzled. The Court pointed out that upon trial the defendant failed to take advantage of Rule 23(c) of the Federal Rules of Criminal Procedure, and, therefore, left unerystallized the question of fact as to the embezzlement, thus "the trial judge was not foreclosed from disbelieving on the evidence before him that Wyss was an embezzler".

Holding in effect that the funds were thus "kick-backs" and not embezzlements, the Court said:

> "Until the funds in question are reclaimed if they were 'kickbacks' we thing they constituted taxable in-

come despite Wyss' alleged vulnerability, if any, under Indiana law to return it when and if, or because of a duty of the Indiana Attorney General or County Attorney to institute recovery proceedings. We are not rescinding *Wilcox*, as defendant's anticipatory argument suggests but observing that *Wyss cannot come within the Wilcox holding unless the district judge found him to be an embezzler. And as both sides unanimously agree this Court does not weigh evidence nor find facts.* Defendant has confused weight and credibility with questions of law." (Emphasis supplied)

Here in the case at bar we have clearly an instance where "the district judge found him to be an embezzler" as a carefully considered portion of the Special Findings of Fact entered upon the conclusion of the trial. It is not a case where there was failure of the petitioner to avail himself of the advantage of Rule 23(c).

The practice of defense counsel straining at facts and evolving theories whereby their clients might be conceived of as embezzlers, previously noted in this brief, and which has regrettably resulted in some of the expressions contained in the cases considered in this portion, is noted in *Wyss* by Judge Finnegan who said:

> "Following in the wake of *Commissioner of Internal Revenue* v. *Wilcox* (citation) an occasional taxpayer has firmly insisted upon being recognized and classed as a self-made embezzler * * *."

In the case at bar, however, the insistence on the existence of an embezzlement was initially asserted by the Grand Jury and District Attorney of Essex County, New Jersey and was additionally found specially as a fact by the Trial Judge.

In *Schira* v. *Commissioner of Internal Revenue*, 240 F.2d 672 (6th CA), (1957), little of value appears, but the same is included here merely as being a decision in which *Wilcox* is distinguished. The distinction is not difficult. Schira stole buckets, galvanized cans and other articles from his employer, sent them by the truck load to a second individual, who in turn sent them to a third individual, who sold them on the open market, and the proceeds of such sales were divided among the three. Indeed, it was far fetched to claim that monies received from the sales were funds which were embezzled from any person whomsoever.

In *Prokop* v. *Commissioner of Internal Revenue*, 254 F.2d 544 (7th CA), (1958), the taxpayer was an office manager for an electrical union and directly received permit fees from temporary workers which she did not report on the books of the union and which she divided with the business manager. In this civil proceeding, it was held that the funds retained by her constituted taxable income despite her reliance on *Wilcox*.

The case actually recognizes *Wilcox*, but turns largely on the fact that Mrs. Prokop had never been "charged with or proceeded against for embezzlement" and that her act has been condoned by her employers, the court saying:

> "Mrs. Prokop here, was never *charged with or proceeded against for embezzlement*. By negotiation she agreed to pay and paid to the Union a definite sum of money in settlement of its claim against her and was given a full and complete release. Any money that had come to her by way of permit fees thus became free of any conflicting rights in the Union. This case is more like *Kann* v. *Commissioner of Internal Revenue*, 3 Cir., 210 F.2d 247 and *Rutkin* v. *United States*, 343 U.S. 130, 72 S.Ct. 571, 96 L.ed. 833. The latter case

limited the authority of the *Wilcox* case to its precise facts. In the *Wilcox* case taxpayer had embezzled funds; had been prosecuted for and convicted of embezzlement; his act had not been condoned nor forgiven by his employer; the embezzled funds in his hands continued to be the property of his former employer. Here, Mrs. Prokop was not charged with embezzlement and whether or not her withholding the permit fees from her employer legally amounted to embezzlement the release she received from Local 494 left no claims by the Union outstanding against her."

Actually, the defense of embezzlement was not pressed in the Tax Court below—and here again we have a case where the embezzlement was largely a theoretical and legalistic thing falling within the quoted comment of Judge Finnegan in the *Wyss* decision referenced above.

Again, it is noted that in *Prokop* we had not an embezzlement, as in *Wilcox* and *James*, but rather an extortion, as in *Rutkin*. That this is so appears from the Government's own argument advanced in its Brief filed in the *Prokop* case, from which we now quote:

"Significantly, in *Rutkin* v. *United States*, 343 U.S. 130, the Supreme Court held the extorted funds were taxable income to the extortionist, and (p. 138) limited *Wilcox* 'to its facts'. The *Rutkin* case involved a situation (obtaining money from another by threats to kill) which is not dissimilar to that in the instant case; the taxpayer's extraction of money by collusion and duress was somewhat comparable though less violent, namely, requiring payments of the permit fees to herself in her own right as the operating head of the union from the temporary permit workers, failing which she would—and did—cause their discharge from local employment."

In *Macias* v. *Commissioner of Internal Revenue*, 255 F.2d 23 (7th CA), (1958), we have a civil proceeding in which one of the questions was whether certain payments received by the taxpayer's husband (with whom she had filed a joint return) were taxable. These were "side payments" or "kick-backs". It was claimed in the Tax Court that these funds (although paid directly to the recipient in his own name) were embezzlements under *Wilcox*. The Tax Court decided this issue of facts adversely to the taxpayer, and the Court of Appeals correctly stated that it would not disturb such findings, saying:

> "Relative to the first issue, petitioner contends that the payments received by Arturo were embezzled funds, and, therefore, not taxable, under the decision of *Commissioner of Internal Revenue* v. *Wilcox*, 327 U.S. 404, 66 S. Ct. 546, 90 L.Ed. 752, Reliance is placed upon the definition of 'embezzlement' contained in Sec. 343.20(1) of the 1947 Wisconsin Statute. It is hardly open to question but that Arturo illegally received payments from Warschawski. Whether such payments constituted embezzlement under the Wisconsin law or any other is doubtful. (In this connection, in fairness to petitioner it should be stated that there is evidence in the record more favorable to petitioner than is shown in the evidentiary findings of the Tax Court heretofore recited). However, we need not indulge in a discussion of this issue because, as petitioner concedes, it is an issue of fact. Such issue was by the Tax Court found adversely to petitioner. We discern no reason to disagree, and we accept the finding."

In *Smith* v. *United States*, 257 F.2d 133 (10th CA), (1958), the defendant, a pander, was convicted for falsely stating to a special agent of the Internal Revenue Service that "he had received no income from any type of prostitution". The facts were that Smith had four prostitutes

working for him. He took their earnings from them, representing that he would keep the same and use such at some future date to acquire a legitimate business in which they would be interested along with him. Again, we had the far fetched contention that this person was an "embezzler", and hence such pander's fees were not income.

In denying this strangely ingenious claim and rightfully distinguishing *Wilcox*, the Court reaffirmed the "claim of right" doctrine, pointing out that in *Wilcox* (as in *James*) the money was taken with no semblance of a claim of right, whereas Smith received the funds from the women "joined in a cooperative undertaking", and that thus "He had a claim of economic right and interest in it".

b. Decisions of Lower Courts reaffirming the full vitality of Wilcox.

From the foregoing it might appear that all pertinent cases, since *Rutkin*, have had the effect of eroding the *Wilcox* doctrine. Such, however, is most definitely not the case. The cases considered in the foregoing portion of this Brief were generally occasioned, as has been pointed out, by the many attempts of non-embezzlers (where prosecution for such crime was impossible or, at best, highly improbable) to have themselves declared criminals of such category in order to escape tax liability.

It is to be noted that in not one of the twelve cases reviewed above was there ever even as much as the threat of an embezzlement indictment. Such existed only in *Wilcox* and again in the *James* case at bar, where actual indictments for such crime were returned.

That *Wilcox's* rule was unchanged by *Rutkin* seems implicit in the decision reached in the early case of *Lashell's*

Estate v. *Commissioner of Internal Revenue*, 208 F.2d 430 (6th CA) Dec. 4, 1953, where the question of the taxability of certain bribe payments made by the taxpayer to the purchasing agent of one of its customers was considered. The Commissioner contended that the money received by the taxpayer and thereafter paid as bribes should be included in the company's return. This money had been received by the taxpayer without claim of right, since it had been agreed that the same be paid as "commissions" to the purchasing agent for the corporation's customer. In refuting the contention of the Commission, the Court said:

> "It is well settled that the mere receipt and possession of money does not by itself constitute taxable income. Familiar examples are borrowed money, rent collected by a rental agent, payment of a loss under an insurance policy, and a money judgment collected by an attorney for a client. 'The very essence of taxable income, as that concept is used in Section 22(a), is the accrual of some gain, profit or benefit to the taxpayer. This requirement of gain, of course, must be read in its statutory context. Not every benefit received by a taxpayer from his labor or investment necessarily renders him taxable. Nor is mere dominion over money or property decisive in all cases. In fact, no single, conclusive criterion has yet been found to determine in all situations what is a sufficient gain to support the imposition of the income tax. No more can be said in general than that all relevant facts and circumstances must be considered.' *Commissioner* v. *Wilcox, supra*, 327 U.S. at page 407, 66 S.Ct. at page 548.
>
> "Using this concept of taxable income, the Supreme court adopted the 'claim of right' rule for the purpose of determining whether the receipt and possession of money constituted income. This rule was expressed

as follows in *North American Oil Consolidated* v. *Burnet, Commissioner*, 286 U.S. 417 at page 424, 52 S. Ct. 613, at pages 615, 76 L. Ed. 1197; 'If a taxpayer receives earnings under a claim of right and without restriction as to its disposition, he has received income which he is required to return, even though it may still be claimed that he is not entitled to retain the money, and even thought he may still be adjudged to restore its equivalent.' This rule was restated in *Commissioner* v. *Wilcox, supra*, 327 U.S. at page 408, 66 S. Ct. at page 549, as follows: '* * * taxable gain is conditioned upon (1) the presence of a claim of right to the alleged gain and (2) the absence of a definite, unconditional obligation to repay or return that which would otherwise constitute a gain. Without some bona fide legal or equitable claim, even though it be contingent or contested in nature, the taxpayer cannot be said to have received any gain or profit within the reach of Section 22(a).' The rule was recently approved and applied in *United States* v. *Lewis*, 340 U.S. 590, 71 S.Ct. 522, 95 L.Ed. 560.

"In the present case there was no claim of right by the company to the commissions charged, collected and thereafter paid over by it to Moon."

Again, and more recently, in *J. J. Dix, Inc.* v. *Commissioner of Internal Revenue*, 223 F.2d 436 (2d CA) June 2, 1955, certiorari denied, 350 U.S. 894, (in an opinion by Judge Frank, joined in by Judge Medina) two of the three Judges who had participated in the earlier decision of *United States* v. *Brusewitz, supra*, the Court expressly reaffirmed *Wilcox* in considering the tax liability of the president of a corporation for corporate funds in the amount of $56,736.82 which he had misappropriated. The language of the Court on the question was:

"The Tax Court held that Jacob Dix realized taxable income of $56,736.82, *i.e.*, the amount of corporate funds he misappropriated. We think this was error. Jacob withdrew those moneys from the corporate bank accounts without the consent, coerced or otherwise, of the company. That he was the president did not amount to corporate consent. We have here a simple case of embezzlement, not one involving a receipt under any color of right. Accordingly, we think *Commissioner of Internal Revenue* v. *Wilcox*, 327 U.S. 404, 66 S.Ct. 546, 90 L.Ed. 833, governs, and that *Rutkin* v. *United States*, 343 U.S. 130, 72 S.Ct. 571, 96 L.Ed. 833, does not apply. We do not believe that *Rutkin* completely obliterated *Wilcox*. 'Since the court in *Commissioner of Internal Revenue* v. *Wilcox* flatly held that embezzled funds were not taxable income to the embezzler, and in the *Rutkin* case has unequivocally held that extorted funds were taxable income to the extortionist, the line of demarcation lies between those rather closely related factual situations and must be determined by the facts in the individual case.' *Marienfeld* v. *United States*, 8 Cir., 214 F.2d 632, 637. In the instant case, the facts are close to those of *Wilcox* and lack the distinguishing features found in *United States* v. *Bruswitz*, 2 Cir., 219 F.2d 59, and cases there cited. See also the dissent of Judge Kalodner in *Kann* v. *Commissioner*, 3 Cir., 210 F.2d 247, 253."

Obviously, in *James* we are even much closer to *Wilcox* than was *Dix*. In *James* the embezzler was not in control of the Union or the Insurance Company, whereas *Dix* was the president of the victim corporation. In *James* we have real, actual pusuit of the monies embezzled, an utter absence of any claim of right, and, moreover, an existing prosecution for embezzlement and the fact of the embezzlement of the funds so found by the District Court.

The Court's attention is also invited to the recent decision in *United States* v. *Peelle*, 159 F. Supp. 45, Eastern

Dist. of N. Y. February 4, 1958, wherein *Rutkin* and *Wilcox* were closely examined. Here so-called "Secret" corporation bank accounts were used by Henry E. Peelle, an officer of the corporation, without knowledge or consent of other officers of the corporation, and monies extracted therefrom for his own personal use. It seems difficult to perceive how a set of facts more closely analogous to the *James* case could be envisioned. The device utilized to effect the embezzlement in both *Peelle* and *James* was virtually identical. In holding *Wilcox* controlling under such a set of facts, the Court in its fulsome and well reasoned opinion said:

> "In support of the defendants' contention that this embezzled money is not taxable to defendant Peelle, *Commissioner of Internal Revenue* v. *Wilcox*, 1946, 327 U.S. 404, 66 S. Ct. 546, 90 L.Ed. 752, is cited. The Tax Court had ruled that embezzled money constituted taxable income to the embezzler. The Supreme Court rules that this was a clear-cut mistake of law."
>
> • • •
>
> "The amounts taken out of these so-called 'secret' bank accounts and embezzled by Henry E. Peelle and converted to his own use and later returned, therefore, are not taxable income."

In *United States* v. *Mavroleon*, 58-1 U.S.T.C. 68, 188 (U.S.D.C. S.D. N.Y. 1958) income taxes were assessed on moneys given to the taxpayer, an employee of a ship chandlery firm, for disbursement by him to third parties. The court held:

> "This defendant either disbursed the money proceeds of the cashed checks or he embezzled it. If he disbursed it, he had no income. If he embezzled it, it is not taxable as income. *Commissioner* v. *Wilcox*, 327 U.S. 404."

Finally, we come to the recent decision in *United States v. Vera Green*, (decided March 31, 1959) in the United States District Court for the District of Massachusetts.

The pertinent facts of the *Green* case, as quoted from the unpublished decision of Judge Wyzanski, are:

> "At all material times Vera Green was the clerk, secretary and director of Botwinik Brothers of Massachusetts. She owned 40 shares out of the 750 shares which had been authorized and issued. Without any authorty from the board of directors and in violation of her duty as an officer, director and employee, she utilized for her personal purposes, or for the purposes of her husband or a corporation in which she was interested, corporate assets belonging to Botwinik Brothers of Massachusetts, Inc. It is quite unnecessary at this stage to recite the form in which these diversions occurred. (Author's Note: These embezzlements amounted to $139,000.00). Some of them were by way of petty cash vouchers, others by way of accounts payable invoices, and others in other ways. From the facts which have been stipulated it is clear that many of these diversions were subject to prosecution and conviction under the State law of Massachusetts governing larceny and, more particularly, under the provisions which incorporate the old common law of embezzlement. In fact, up to now Mrs. Green has not been prosecuted in the state courts for this larceny. It does not appear whether she will hereafter be prosecuted in view of the admissions made in connection with these proceedings."

The ruling the Court then follows:

> "With respect to the joint income tax returns, I am cabined by the decision rendered by the Supreme Court of the United States in *Commissioner* v. *Wilcox*, 327 United States 404 (1946). The Supreme Court of the United States 13 years ago decided that embezzled money does not constitute taxable income to

the embezzler under Section 22(a) of the Internal Revenue Code. It makes no difference whether I do or do not agree with that ruling. The Supreme Court has not impaired its authority. Indeed, in refusing to review the decision of the Second Circuit rendered in *J. J. Dix, Inc.* v *Commissioner,* 223 Federal 2d, 436, it seems as though the Supreme Court of the United States is quite content to leave the *Wilcox* doctrine stand. Moreover, the Congress of the United States has not chosen to alter the doctrine in the *Wilcox* case. It is undeniable that the decision of the Supreme Court was reported to Congressional Committees and that despite this report and despite a recodification and general overhauling of the Internal Revenue Code within the last decade, no legislative alteration in the *Wilcox* doctrine has been made. It would be unseemly for a District Judge, in the light of these circumstances, not to follow the *Wilcox* case, and it would be particularly undesirable for a single District Judge to create fine distinctions between the *Wilcox* case and the facts of this case, which is a criminal proceeding.

"Needless to say, if the Government feels that distinctions urged before me are of great importance, and should be presented to a bench of several judges, it is possible for the Government to proceed civilly against these defendants, and then if the Government loses in the civil action to take appropriate appeal to bring the matters before higher tribunals.

"In all cases it is of importance for the Court not only to act justly but to appear to act justly, and it would appear to many people to be shocking in a criminal case for a single judge to enunciate fine-spun distinctions between that case and what has commonly been regarded as a landmark case in the Supreme Court of the United States.

"The motion is granted *in toto.* The defendant stands acquitted."

5. Comments on Bases Expressed in Opinion Below.

The petitioner finally desires to briefly comment on certain of the expressions contained in the opinion below (R. 19) as reasons advanced by the Seventh Circuit Court of Appeals for its affirmance of the District Court's judgment of conviction herein. (273 F.2d 5).

For one thing, it is observed that the pronouncement of the Seventh Circuit below to the effect that the rule of *Wilcox* was in question since it "resorted to *state* law in determining the absence of a bona fide claim of right to the alleged gain and the existence of an obligation to repay it" (R. 21), thus permitting state law to establish criteria of federal taxability. It is felt that the short answer to this position is simply that it is not true. The holding of *Wilcox* is that the embezzlement of money is not a taxable event for the purposes of the federal income tax. The term "embezzlement", like the term "loan", which also refers to a non-taxable event, has a universally accepted meaning which is subject only to minor and immaterial variations under state law. This meaning was expressed simply and directly by this Court in *Moore* v. *United States*, 160 U.S. 268, 269 (1895) as:

> ". . . a fraudulent appropriation of property by a person to whom such property has been instrusted or into whose hands it has lawfully come."

Since the decision in *Rutkin* this Court has continued to refer to embezzlement, in a general sense and without regard to state law, as having important and specific tax ramifications. *Alison* v. *United States, supra.*

It is also readily acknowledged, as stated in the opinion below, that "Congress establishes its own criteria and the state law may control only when the federal taxing

act by express language or necessary implication makes its operation dependent upon state law" (R. 21).

But if Congress has intended to tax monies obtained by embezzlement, it could and probably would have altered the *Wilcox* rule in the broad revision of the Internal Revenue Code of 1954.[1]

Also true, as stated in *Rutkin* and reiterated in the opinion below, "An unlawful gain, as well as a lawful one, constitutes taxable income when its recipient has such control of it that, as a practical matter, he derives readily realizable economic value from it" (R. 20).

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[1] In connection with the failure of Congress to change **Wilcox**, it is to be noted that in H.R. 8854, a Bill introduced in the 86th Congress, an effort is being made by the Congress to change the rule of **Wilcox**. This Bill provides, **in toto**, as follows:

"A BILL

To amend the Internal Revenue Code of 1954 to provide that the proceeds of certain crimes shall be included in gross income.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That (a) part II of subchapter B of chapter 1 of the Internal Revenue Code of 1954 (relating to items specifically included in gross income) is amended by adding at the end thereof the following section:

'Sec. 78. PROCEEDS OF CERTAIN CRIMES.

'The proceeds of embezzlement, or of larceny, burglary, or robbery, shall be included in gross income for the taxable year in which derived, except to the extent restored to the rightful owner before the expiration of the period provided by section 6511 for filing claim for credit or refund with respect to such year.'

(b) The table of sections for such part II is amended by adding at the end thereof the following new item:

'Sec. 78. Proceeds of certain crimes.'

Sec. 2. The amendments made by the first section of this Act shall apply only with respect to the proceeds of crimes committed after the date of the enactment of this Act."

But this quotation from *Rutkin* fails to consider the true issue, *i.e.*, what constitutes a *gain*. The holding of this Court in *Wilcox* was not that unlawful gains are tax-free; it was, rather, that the *event* of embezzlement *does not result in a gain* to the taxpayer because he holds without ownership or claim of right, is under an immediate, unconditional and practically significant obligation to repay. It is events, not moneys which are subject to tax. The embezzler simply does not realize a gain, that is, because his receipt of the funds is immediately offset by an exactly corresponding liability which has true economic significance. The transaction thus differs markedly from any other, lawful or unlawful, which results in a gain; it resembles most closely a loan, where the supplier of the money also possesses an unconditional and practically valuable right of recovery.

Section 22(a) of the 1939 Internal Revenue Code has, of course, long been construed as evidencing Congress' intent to tax all *gains and profits* except those specifically exempted. No one disputes this principle, but as applied to the present issue, to repeat this truism merely begs the question. In ruling that Wilcox did not realize a gain, making him subject to tax, this Court pointed out that he had received the money without any semblance of a bona fide claim of right and was at all times under an unqualified duty and obligation to repay the money, title to which was with his employer and with whom his debtor-creditor relationship was definite and unconditional.

Lastly, the petitioner cannot agree with the conclusion that proceeds of embezzlements should be considered taxable, as "Congress, in enacting Section 22(a) 'applied no limits as to the source of taxable receipts nor restrictive labels, as to their nature;' and that it thereby intended

'to tax all gains except those specifically exempted', and thus 'to bring the taxing power to bear upon all receipts constitutionally taxable * * *'" (R. 21).

It should scarce be argued that the failure of Congress to specifically exempt embezzled funds from the general definition of Gross Income contained in the Internal Revenue Code (Section 22(a), Internal Revenue Code of 1939, and Section 61 of Internal Revenue Code of 1954) is to be construed as indicating the intent of Congress to include such funds. In the first place, as has been heretofore noted, *Wilcox* declared such funds not included in the concept of gain or profit, and the Congress did not see fit in 1954 to legislatively disturb such declaration when the effect of *Wilcox* was well known and a general revision of the Internal Revenue Code was made. Secondly, to so argue would be to gratuitously assume that embezzlement does result in a *gain*, despite the ruling of this Court to the contrary. One may well ask, where in the Code Congress specifically exempted "*gains*" arising from loans? Section 22(b) of the 1939 Code sets forth sixteen sub-sections enumberating types of *gains* which are exempt from tax. Gifts, which obviously are *gains*, are mentioned, whereas the proceeds of loans are no where touched upon. The obvious reason is that loans and embezzlement alike give rise to corresponding and significant obligations to repay, which means they do not result in "*gains*" and that neither, therefore, requires listing as a *gain* which is exempt from the tax.

For these reasons the *Wilcox* decision in no way contravenes the presumed intention of Congress but merely holds that a transaction of this type does not invoke tax liability because the taxpayer has failed, in both fact and in law, to make a net economic advance.

The foregoing leads to the following conclusions:

(1) Although the broad *rationale* of the *Wilcox* case may appear to have been violated by the *Rutkin* decision, the *holding* of *Wilcox* is still the law, as demonstrated by the facts that:

(a) This Court in *Rutkin* did *not* overrule *Wilcox* but explicitly reaffirmed its holding;

(b) This Court in *Alison* cited *Wilcox* with approval, referred to the special nature of the crime of embezzlement and distinguished embezzlement from other unlawful acquisitions on the ground that the victim possesses an unconditional and practically valuable right of recovery;

(c) Congress did not disturb the *Wilcox* holding despite a complete overhaul of the Internal Revenue Code in 1954; and

(d) The Court of Appeal and District Courts, other than in the case here at bar, have not treated *Wilcox* as overruled and have applied its doctrine in similar fact situations.

(2) The facts of the instant case, being specifically found by the Trial Judge and not here in dispute, are controlled by the *Wilcox* rule. The petitioner obtained the funds by embezzlement, with no claim of right, either actual or pretended, and under circumstances which vested in the true owner an immediate, unconditional and a practically valuable right of recovery.

(3) Accordingly, petitioner did not receive unreported taxable income.

CONCLUSION.

The Judgment against Petitioner should be reversed and judgment of acquittal directed.

Respectfully submitted,

JOSEPH E. GREEN
RICHARD E. GORMAN
One North LaSalle Street
Chicago 2, Illinois
Telephone: CEntral 6-7722

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No. 63

In the Supreme Court of the United States

OCTOBER TERM, 1960

EUGENE C. JAMES, PETITIONER

v.

UNITED STATES

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE UNITED STATES

J. LEE RANKIN,
Solicitor General,
CHARLES K. RICE,
Assistant Attorney General,
HOWARD A. HEFFRON,
Assistant Deputy Attorney General,
MEYER ROTHWACKS,
JOHN J. McGARVEY,
Attorneys,
Department of Justice, Washington 25, D.C.

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In the Supreme Court of the United States

OCTOBER TERM, 1960

No. 63

EUGENE C. JAMES, PETITIONER

v.

UNITED STATES

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE UNITED STATES

OPINION BELOW

The opinion of the Court of Appeals (R. 19–22) is reported at 273 F. 2d 5.

JURISDICTION

The judgment of the Court of Appeals (R. 22)[1] was entered on December 29, 1959. A petition for rehearing (R. 23) was denied on February 29, 1960. The petition for writ of certiorari was filed on March 26, 1960, and was granted on May 16, 1960, 362 U.S.

[1] References preceded by "R." are to the printed record; those preceded by "Tr." are to the official court reporter's transcript of proceedings at the trial—in four volumes covering 552 pages—no part of which has been printed. A stipulation has been filed with the Court providing that either party may refer on brief and at the argument to the unprinted portions of the record.

974. (R. 24.) The jurisdiction of this Court is invoked under 28 U.S.C. 1254 (1).

QUESTION PRESENTED

Whether funds misappropriated by petitioner were taxable income to him.

STATUTES INVOLVED

Internal Revenue Code of 1939:

SEC. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service * * * of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

(26 U.S.C. 1952 ed., Sec. 22(a).)

SEC. 145. PENALTIES.

* * * * * *

(b) *Failure to Collect and Pay Over Tax, or Attempt to Defeat Tax.*—Any person required under this chapter to collect, account for, and pay over any tax imposed by this chapter, who willfully fails to collect or truthfully account for and pay over such tax, and any person who willfully attempts in any manner to evade or defeat any tax imposed by this chapter or the payment thereof, shall, in addi-

tion to other penalties provided by law, be guilty of a felony and, upon conviction thereof, be fined not more than $10,000 or imprisoned for not more than five years, or both, together with the costs of prosecution.

* * * * *

(26 U.S.C. 1952 ed., Sec. 145(b).)

Internal Revenue Code of 1954:

SEC. 61. GROSS INCOME DEFINED.

(a) *General Definition.*—Except as otherwise provided in this subtitle, gross income means all income from whatever source derived * * *.

* * * * *

(26 U.S.C. 61(a).)

SEC. 7201. ATTEMPT TO EVADE OR DEFEAT TAX.

Any person who willfully attempts in any manner to evade or defeat any tax imposed by this title or the payment thereof shall, in addition to other penalties provided by law, be guilty of a felony and, upon conviction thereof, shall be fined not more than $10,000, or imprisoned not more than 5 years, or both, together with the costs of prosecution.

(26 U.S.C. 7201.)

STATEMENT

On December 13, 1957, an indictment in four counts was returned against petitioner in the United States District Court for the Northern District of Illinois, charging wilful attempts to evade and defeat a large part of the income tax due and owing by him and his wife for each of the years 1951 through 1954, in violation of Sections 145(b) and 7201 of the Internal Revenue Codes of 1939 and 1954, respectively. (R.

3–5.) The amounts of petitioner's reported and correct net income and tax liability, as alleged in the indictment, are as follows (omitting cents) (R. 3–5):

Year	Reported		Corrected	
	Income	Tax Liability	Income	Tax Liability
1951	$13,375	$2,353	$123,827	$70,037
1952	23,203	5,997	233,469	166,195
1953	15,223	3,107	407,229	325,323
1954	15,809	2,962	45,371	15,847

After a trial to the court—a jury having been waived—petitioner was found guilty on all counts. (R. 14–16.) On May 11, 1959, he was sentenced to imprisonment for three years—one year on count 1, and two years on each of counts 2, 3 and 4, the sentences on the latter counts to run concurrently with each other but consecutive to the sentence imposed on count 1. (R. 16–17.) The Court of Appeals unanimously affirmed. (R. 19–22.)

The Government does not controvert petitioner's statement of the case. (Pet. Br. 4–15.) The facts—many of which were stipulated (Tr. 22–23, 41–53, 59–68, 196–198, 234–235, 237–238, 300–301, 342–343, 419–420)—were found specially (R. 6–16) by the court and are not in dispute. The unreported income alleged in the indictment consists of funds which petitioner misappropriated, in part from an insurance company and in part from a labor union of which he was an officer. Both the trial and reviewing courts ruled that such funds are taxable gains to petitioner in the years in which the misappropriations occurred.

At all times material, petitioner was General Secretary-Treasurer (initially in an acting capacity) of the Laundry Workers International Union, which had its headquarters in Indianapolis, Indiana. In addition, he was managing trustee of Local No. 46 of the Union which served the Chicago, Illinois area. (R. 7.)

In May 1949, a resolution was adopted, at a convention of the International Union, authorizing the Union's executive board—which was comprised of the officers of the International—to set up a welfare and pension plan for the membership. To effectuate this purpose, the executive board caused a welfare trust to be created in January 1950, known as the Social Security Department of the Laundry Workers International Union. The Social Security Department became a separate division of the International Union. It was governed by six trustees, three of whom were selected by the Union and three by management. Petitioner never served as a trustee of the Social Security Department. (R. 7-8.) Under the welfare plan adopted by the International Union, members were entitled to death benefits and to health and accident insurance coverage. (Tr. 62.)

The welfare plan was financed by contributions from employers. Each local affiliated with the International Union entered into separate contracts with employers providing for payments by the latter into the welfare fund. Pursuant to these contracts, each employer transmitted, monthly, to the local of which its employees were members, a check covering the employers contribution to which was attached a statement

listing the names of the employees and the period covered by the remittance. The various locals, in turn, transmitted the checks and attached statements of coverage to the Social Security Department. (R. 8.)

In the early part of 1950, the Social Security Department entered into group insurance contracts with the Security Mutual Life Insurance Company of Binghamton, New York, which provided health and accident insurance coverage and medical and surgical benefits for members of the International Union. The insurance company appointed Louis B. Saperstein, an insurance broker in Newark, New Jersey, as its general agent to service these policies. The premium rates, however, were fixed by the company. (R. 8–9; Tr. 62.)

Beginning in March 1951, the Social Security Department forwarded, periodically, the correct amounts of all premiums due on the policies to Saperstein, at Newark, New Jersey, by checks drawn to his order. Each check was accompanied by a statement showing the local union for which the payment was made, the number of employees covered, and the dates of their coverage. Saperstein did not remit to the Insurance Company the full amount of all premiums (less his commission) received from the Social Security Department. Huge sums were withheld by him and misappropriated from the insurance company. Saperstein accomplished his misappropriations by arbitrarily reducing the number of employees covered by certain remittances, and consequently the amount of the premium payable, or by deferring the coverage of groups of employees for whom remittances were re-

ceived. Saperstein used a part of the funds withheld in this manner to pay claims made by employees who, under the terms of the policies, were entitled to benefits; the balance was paid over to petitioner by checks drawn to the order of the Laundry Workers International Union and mailed to petitioner, either at his residence in Wheaton, Illinois, or at an office he maintained in the headquarters of Local No. 46 in Chicago. During the years in question, the checks received by petitioner from Saperstein totaled $653,646. (R. 9–10; Tr. 64–68, 73–195.)

The union had no knowledge of the receipt by petitioner of the Saperstein checks. The checks were deposited by petitioner to a "secret" bank account which he maintained, in the name of the Laundry Workers International Union, at the Merchants National Bank in Chicago. During the period in question, all funds deposited to this account were withdrawn by petitioner, in cash, and applied to his own use and benefit. (R. 9–14; Tr. 41, 44–46, 66–68.)

The trial court, noting the provision of New Jersey law which makes an aider and abettor in the commission of crime guilty as a principal, concluded that the sum of $653,646 received by him from Saperstein was embezzled by petitioner from the Security Mutual Life Insurance Company.[2] (R. 10.)

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[2] In 1957, petitioner and Saperstein were indicted in Essex County, New Jersey, for conspiracy to embezzle and for embezzlement of the funds here in question; they were also indicted for conspiracy to obtain money under false pretenses and for the substantive offense. The indictments alleged the embezzlement of some $650,000 and the obtaining under false pretenses of an additional $285,000. (R. 10; Tr. 526–527, 530–

During the years 1951 to 1953, petitioner misappropriated $85,000 from the Laundry Workers International Union in the following manner: In July 1951, he wrote two letters to the Security Mutual Life Insurance Company, in his capacity as secretary-treasurer of the International Union, in which he represented to the Insurance Company that the International Union had incurred, and would continue to incur, substantial expense in promoting and servicing the group insurance policies issued by the Company; he thereupon requested that the union be reimbursed for these expenditures. The Insurance Company responded by agreeing, in September 1951, to pay the International Union the sum of $2,500 a month to defray such expenses, retroactive to January 1951. Pursuant to this agreement, the Insurance Company issued one check, in the amount of $20,000, payable to the International Union, covering the retroactive period; one check, in the amount of $2,500, payable to petitioner, covering the month of September 1951; and monthly checks thereafter, each in the amount of $2,500 payable to petitioner as secretary-treasurer of the International Union. All of these checks were mailed to petitioner, endorsed by stamp, and deposited by him to the "secret" account he maintained in the Merchants National Bank. As previously noted, all sums deposited to this account were withdrawn by petitioner during the years in question and applied

531, 535, 537–540; Def. Exs. 12 and 13: Govt. Exs. 543 and 544.) We have been advised by the office of the prosecutor of Essex County that on September 20, 1960, both petitioner and Saperstein entered pleas of guilty of the offense of conspiracy to embezzle.

by him to his own use and benefit. The sums so received by petitioner in each of the years 1951, 1952 and 1953, amounted to $30,000, $32,500, and $22,500, respectively, totalling $85,000. (R. 10–14.)

The trial court concluded that, under the law of Illinois, this sum of $85,000 was embezzled by petitioner from the Union. (R. 11.)

Subsequent to the years in question, suits were filed, the first in July 1956, by certain beneficiaries of the Social Security Department—who brought class actions—and by the trustees of the Social Security Department, against petitioner, Saperstein, the Security Mutual Life Insurance Company, and the Merchants National Bank, to compel restitution of the misappropriated funds. In July 1958, the various suits were settled by agreement of the parties, which agreement was approved by the Superior Court of Cook County, Illinois, and the United States District Court for the Northern District of Illinois. The agreement was based upon a judicial determination that, as a result of the misappropriations, the Social Security Department was damaged to the extent of $262,137—the amount which it would have received by way of rebates or dividends if all premiums paid on the group policies had been remitted by Saperstein to the Insurance Company. Under the terms of the settlement, the defendants paid over to the Social Security Department the following sums: the Security Mutual Life Insurance Company, $125,000, the

[3] Suits were filed against one or more of the above named parties in the state courts of California, Illinois and New Jersey, and in Federal District Court in Illinois and New Jersey. (Exs. 1–11.)

Security Mutual Life Insurance Company and the Merchants National Bank, $110,000, and petitioner and Saperstein, $13,568.50, each; thereupon, releases were executed relieving the parties defendant from further liability. (Tr. 482–518; Deft. Exs. 1 to 11, inclusive.)

Thus, while petitioner misappropriated approximately three quarters of a million dollars during the years in question, he was required to make restitution in a subsequent year to the extent of $13,568.50.

SUMMARY OF ARGUMENT

I

This case presents the naked legal question whether embezzled funds are taxable gains to the embezzler in the years in which misappropriated. In the Government's view, apart from the case of *Commissioner* v. *Wilcox*, 327 U.S. 404, the decisions of this Court construing the statute have established criteria for determining taxable gains which clearly show that embezzled funds are taxable income to the embezzler.

In construing the statutory definition of gross income in the Internal Revenue Code this Court has proceeded upon the fundamental premise that Congress intended to exercise the full measure of its taxing power. The Court has held that taxable gains are not restricted to receipts from particular sources such as conventional "capital" or "labor"; even "windfalls" are taxable as income. The source from which the receipts are derived does not control. Income is characterized as an "accession to wealth" of

the taxpayer resulting from the economic benefit which the taxpayer realizes from the receipts.

Further, the landmark decisions of this Court demonstrate that the certainty of permanent retention of the receipts by the taxpayer is not a *sine qua non* for a finding of taxable gains. So long as the taxpayer enjoys the benefits of proprietorship, the fact that he acquired the receipts illegally and that he may be required later to repay them to another does not preclude their inclusion in his taxable income. Repayment, if and when it occurs, would diminish the embezzler's income. Technical refinements do not control, for the reach of the taxing acts is determined by the practical substance of transactions and the incidence of economic benefits.

These general principles are applicable to receipts derived from illicit activities. In *Rutkin* v. *United States*, 343 U.S. 130, the fundamental principles of income taxation were applied by the Court in holding that the receipts of extortion are taxable income. It was not deemed material that the extortionist had no bona fide legal or equitable claim to the proceeds or that the victim had a clear right to sue for restitution. The controlling factor was the extortionist's enjoyment of the proceeds from which he derived, in every substantial sense, readily realizable economic value. The case of the embezzler is no different from that of the extortionist. The embezzlement of funds cannot be assimilated to a capital transaction such as a loan because the embezzler in the practical economic sense realizes an "accession to wealth" which the borrower does not.

11

The case of *Commissioner* v. *Wilcox, supra,* which held embezzled funds were not income, represents a departure from the long and consistent line of authority in this Court establishing broad tests for determining taxability of gains. As such, it represents a misapplication of fundamental principles to which the rule of *stare decisis* does not require adherence. In *Rutkin* v. *United States, supra,* which was decided subsequently, this Court expressly limited the *Wilcox* case to its facts, deliberately left it devoid of precedential authority, and reaffirmed the basic principles of income taxation previously established. Having rejected the rationale of *Wilcox*, the Court perforce rejected the holding.

Since *Rutkin*, the vast majority of lower courts considering the question have determined that the *Rutkin* rather than the *Wilcox* reasoning is to be applied in situations logically indistinguishable from *Wilcox*. Thus, their views coincide with those of the Government that the *Wilcox* rationale was rejected in *Rutkin* and could not thereafter be deemed to be the law.

If the *Wilcox* "claim of right" reasoning, rejected in *Rutkin*, were now to be resurrected by this Court, a variety of illicit receipts which have been held to be income by the lower courts would be granted a tax exemption. Moreover, the application of the fundamen-

tal principles of income taxation, insofar as lawful gains are concerned, would become unsettled. And, as *Rutkin* held, there is no room in the statutory language for distinctions in criteria for taxable gains applicable to lawful or unlawful receipts. Any attempt to reconcile *Wilcox* and *Rutkin* based upon asserted differences between extortion and embezzlement would be inconsistent with fundamental principles of the income tax. Such a result might inaugurate a new series of litigations by taxpayers contending that their activities were embraced within the various and disparate state statutes concerning embezzlement. The alternative to these unsatisfactory courses is acknowledgment that *Rutkin* left *Wilcox*, as authority, with no force whatever.

In the Government's view *Rutkin* represents a proper application of fundamental principles, is sound, and should be adhered to here. To follow *Wilcox* now, as petitioner urges, would be to overrule *Rutkin*, which authoritatively declared the controlling legal principles in this area. It would require extreme grounds to justify such an extraordinary result. None is here advanced. Under the economic use and benefit test of *Rutkin* and the other basic decisions of this Court, embezzled funds are clearly income, as the lower courts have generally recognized. The correctness of their view should now be declared by this Court.

ARGUMENT

I

THE COMPREHENSIVE DEFINITION OF TAXABLE INCOME ESTABLISHED IN THIS COURT'S DECISIONS EMBRACES THE GAIN DERIVED BY PETITIONER FROM THE USE AND ENJOYMENT OF THE FUNDS MISAPPROPRIATED BY HIM

The sole issue presented by the petitioner and before this Court is whether certain receipts in excess of $738,000, the fruits of an embezzlement scheme conducted over a period of four years, were taxable gains required to be reported in the income tax returns filed by him for the years in which the misappropriations took place. In *Commissioner* v. *Wilcox*, 327 U.S. 404, upon which petitioner relies, the Court held that embezzled funds were nontaxable receipts. Our contention is that the lower courts, viewing *Wilcox*—with which we shall deal subsequently—as no longer possessing vitality as precedent, and following the controlling decisions of this Court, correctly held that embezzled funds are plainly "gains * * * from any source whatever" and hence subject to tax.

The basic premise on which the Court proceeds in construing the statutory definition of gross income in the Internal Revenue Code[1] has been frequently stated. "The broad sweep of * * * language indicates the purpose of Congress to use the full measure of its taxing power within those definable categories," *Helvering* v. *Clifford*, 309 U.S. 331, 334, and the con-

[1] As the Court noted in *Commissioner* v. *Glenshaw Glass Co.*, 348 U.S. 426, the simplification of the language in the gross income definition of the 1954 Code (§ 61(a)) was not intended to affect its scope. 348 U.S. at 432.

struction of the statute "should be consonant with that purpose." *Ibid.* "The income tax is described in sweeping terms and should be broadly construed in accordance with an obvious purpose to tax income comprehensively." *Commissioner* v. *Jacobson*, 336 U.S. 28, 49. And see further, *e.g.*, *Irwin* v. *Gavit*, 268 U.S. 161, 166; *Douglas* v. *Willcuts*, 296 U.S. 1, 9; *United States* v. *Safety Car Heating Co.*, 297 U.S. 88. The "broad phraseology" reflects "the intention of Congress to tax all gains except those specifically exempted." *Commissioner* v. *Glenshaw Glass Co.*, 348 U.S. 426, 430. Moreover, the Court has ruled that gross income is defined in such breadth that the statute constitutes a "clear legislative attempt to bring the taxing power to bear upon all *receipts* constitutionally taxable * * *." *Id.* at 433. (Emphasis added.)

The Court has removed the restrictions erroneously drawn from the definition in *Eisner* v. *Macomber*, 252 U.S. 189, 207, which seemed to limit income to gain derived from "capital" or "labor". In *Glenshaw Glass, supra*, the taxpayer had received punitive damages for fraud and antitrust violations. As the beneficiary of a penalty imposed upon the payor for his culpable conduct to vindicate public policy, it contended that the receipt in question was a "windfall" not derived from "capital" or "labor" and hence not taxable. Although the Court accepted the taxpayer's characterization, it held the "windfall" taxable because Congress "applied no limitations as to the source of taxable receipts, nor restrictive labels as to their nature." 348 U.S. at 429–430. Since the

punitive damages were "accessions to wealth" which were "clearly realized", over which the taxpayers had "complete dominion", and were not within any express exemptions, they were includible in gross income without regard to their source.

Moreover, a gain otherwise includible in income is taxable when received even though there is no certainty of its permanent retention by the recipient. Thus, receipts over which the taxpayer asserts proprietorship rights are income even though when received their ultimate disposition is subject to the vicissitudes of pending litigation and a court may later determine that the taxpayer "is not entitled to retain the money" and is "liable to restore its equivalent." *North American Oil* v. *Burnet*, 286 U.S. 417, 424. The same result follows when by mistake the taxpayer is paid money to which he is not entitled (*United States* v. *Lewis*, 340 U. S. 590), or extracts money unlawfully (*Rutkin* v. *United States, supra*). See, also, *Healy* v. *Commissioner*, 345 U.S. 278, 282–283. In other words, the contingency that the receipt may not be retained permanently by the taxpayer does not mean that it is any the less a gain when received.

Nor do concepts of the common law of property or title limit the breadth of the definition of gain for federal tax purposes. "Title" has been repeatedly rejected as a limitation on the scope of Section 22(a) of the 1939 Code. Taxation, as the Court has noted, is an "eminently practical" matter. *Tyler* v. *United States*, 281 U.S. 497, 503; *United States* v. *Jacobs*, 306 U.S. 363, 370. Tax liability, it is clear, "may

rest upon the enjoyment by the taxpayer of privileges and benefits so substantial and important as to make it reasonable and just to deal with him as if he were the owner, and to tax him on that basis." *Burnet* v. *Wells*, 289 U.S. 670, 678. Not only ownership, but also "any right or privilege that is a constituent of ownership" may be taxed. *Ibid.* Section 22(a) has been held in other situations to embody an exercise of the power to tax, as income, the acquisition of practical, substantial benefits other than bare legal ownership. *Helvering* v. *Clifford*, 309 U.S. 331; *Helvering* v. *Horst*, 311 U.S. 112. In short, the reach of the taxing acts is to be determined by the practical substance of transactions, the incidence of economic benefits, and by the "actual command over the property taxed—the actual benefit for which the tax is paid," rather than by the technical refinements of title. *Corliss* v. *Bowers*, 281 U.S. 376, 378; *Lucas* v. *Earl*, 281 U.S. 111, 114–115; *Helvering* v. *Horst*, *supra*.

Nor has the illicit nature of an activity under state law been deemed to be a reason for holding that such activity is beyond the federal taxing power. In *United States* v. *Kahriger*, 345 U.S. 22, the Court, upholding the levy by Congress of an occupational tax of $50 per year on persons engaged in the business of accepting wagers against the contention that the tax was merely a device for regulating gambling unlawful under state law, stated: "It is axiomatic that the power of Congress to tax is extensive and sometimes falls with crushing effect on businesses deemed unessential or inimical to the public welfare,

or where, as in dealings with narcotics, the collection of the tax also is difficult." 345 U.S. at 28. Even earlier, in *United States* v. *Constantine*, 296 U.S. 287, it was made clear that an illicit enterprise could be the subject of a tax. There, although the majority declared unconstitutional an *extra* excise tax on liquor dealers operating in violation of state law which substituted for the normal tax on lawful dealers, it was noted that: "The burden of the tax may be imposed alike on the just and the unjust. It would be strange if one carrying on a business the subject of an excise should be able to excuse himself from payment by the plea that in carrying on the business he was violating the law. The rule has always been otherwise." 296 U.S. at 293. Mr. Justice Cardozo would have gone further and validated imposition of a special tax solely on illicit liquor dealers. In a dissenting opinion joined by Justices Brandeis and Stone, he stated (296 U.S. at 297):

> Congress may reasonably have believed that in view of the attendant risks, a business carried on illegally and furtively is likely to yield larger profits than one transacted openly by law-abiding men. Not repression, but payment commensurate with the gains is thus the animating motive. The gains in all likelihood will seldom be exhausted by a tax of $1,000. Congress may also have believed that the furtive character of the business would increase the difficulty and expense of the process of tax collection. The Treasury should have reimbursement for this drain on its resources.

> Apart from either of these beliefs, Congress may have held the view that an excise should be so distributed as to work a minimum of hardship; that an illegal and furtive business, irrespective of the wrongdoing of its proprietor, is a breeder of crimes and a refuge of criminals; and that in any wisely ordered polity, in any sound system of taxation, men engaged in such a calling will be made to contribute more heavily to the necessities of the Treasury than men engaged in a calling that is beneficent and lawful.

It follows that those same principles comprehensively defining taxable income also apply to receipts derived from illicit activities. Such proceeds are taxable income, despite their illicit source, provided they otherwise qualify as "gain". In *United States* v. *Sullivan*, 274 U.S. 259, the first case in which this Court passed upon taxability of gains derived from unlawful sources, it held that gains from illicit traffic in liquor fell within the broad sweep of gross income as defined by Congress. In doing so it rejected the argument that "proceeds of crimes against the laws of the United States cannot be considered as [gross] income" (p. 262) under the revenue laws. Speaking for the Court, Mr. Justice Holmes stated: "We see no * * * reason why the fact that a business is unlawful should exempt it from paying the taxes that if lawful it would have to pay." 274 U.S. at 263. In *Johnson* v. *United States*, 318 U.S. 189, the Court sustained the conviction of a local political leader for evading taxes on payments received from gamblers for protection against police interference. And a conviction for

evading taxes on gambling gains was upheld in *United States* v. *Johnson*, 319 U.S. 503.

These diverse strains of authority, each of which serves to reinforce the breadth of interpretation to be accorded the definition of gross income, were embodied and expressed in *Rutkin* v. *United States*, 343 U.S. 130.* Rutkin, coupling a spurious claim of right, which the Court noted (p. 136) the victim did not believe, with threats of harm to the victim and his family, extorted $250,000 in the taxable year. Holding that extortion proceeds were taxable gains, which Rutkin was required to report as income, the Court affirmed his conviction for tax evasion. The illicit acquisition of the gains was no obstacle. "Unlawful" gains were taxable. That the gains did not accrue from conventional "labor" was not pertinent, for the statute reached gains "derived from any source whatever." (p. 138.) Rutkin's lack of outright ownership, *i.e.*, the defeasible title of the extortionist, was no ground for exemption, for "assailable unlawful gains should [not] be treated differently in this respect from assailable lawful gains." (p. 137.) In sum, the fruit of extortion was income because the extortionist's "control over the cash so received [is] such that" he can "enjoy its use as fully as though his title to it were unassailable," he has "freedom to dispose of [the cash] at will", he "has such control over it that, as a practical matter, ~~and therefore~~ he derives readily realizable economic value from it." (pp. 136–137.)

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* We reserve for consideration later (Point II, *infra*) the intervening decision in *Commissioner* v. *Wilcox*, 327 U.S. 404.

As this Court stated (in terms which are dispositive in this and all unlawful gain cases) (pp. 137-138):

> An *unlawful gain*, as well as a lawful one, constitutes taxable income when its recipient has such control over it that, as a practical matter, he derives readily realizable economic value from it. *Burnet* v. *Wells*, 289 U.S. 670, 678; *Corliss* v. *Bowers*, 281 U.S. 376, 378. * * * [Emphasis supplied.]
>
> Such gains are taxable in the yearly period during which they are realized. This statutory policy is invoked in the interest of orderly administration. "[C]ollection of the revenue cannot be delayed, nor should the Treasury be compelled to decide when a possessor's claims are without legal warrant." *National City Bank* v. *Helvering*, 98 F. 2d 93, 96. There is no adequate reason why assailable unlawful gains should be treated differently in this respect from assailable lawful gains. Certainly there is no reason for treating them more leniently. *United States* v. *Sullivan*, 274 U.S. 259, 263.

Notwithstanding that Rutkin had no bona fide legal or equitable claim to the proceeds and that the victim had a clear right to sue for their recovery, all of which the Court assumed, the extortion receipts were held taxable. Clearly as a matter of "[c]ommon understanding and experience * * * the touchstones for the interpretation of the revenue laws" (*Helvering* v. *Horst*, *supra*, p. 118), Rutkin had income. And the Court's opinion (343 U.S. at 137) cited "many kinds" of unlawful gains that are taxable under § 22(a): bribes, protection payments to racketeers, ransom

money received by kidnappers, graft, black market gains, illegal lotteries, bets, etc.

This voluminous body of authority, which represents a history of successively widening applications of Section 22(a), compels the conclusion that, along with the plunder of extortion and other unlawful gains, the loot of embezzlement is income. The criteria for taxable gains defined by the decisions of this Court are fully satisfied in the case of the embezzler. As is now beyond dispute, the illicit source of the fruit of embezzlement is irrelevant in determining whether taxable income has been realized. What is relevant and controlling is the complete dominion and control enjoyed by the embezzler over his loot, which give him the economic, though not the legal, benefits of ownership. For all practical purposes, the embezzler treats it as *his* money; and it is these significant attributes of ownership and incidence of economic benefits which, under decisions of this Court in diverse situations involving both licit and illicit income, are determinative of taxable income.

Certainly, embezzlement cannot be distinguished from extortion and other crimes on the ground, asserted here by petitioner (Br. 21, 27, 52–53), that an embezzler realizes no gain by his taking because the law imposes upon him an obligation to make restitution. There is nothing unique about the embezzler's legal duty to make restitution. The law imposes a like obligation on all miscreants—the extortioner no less than the embezzler. Moreover, the Court made it plain in *Rutkin* that, absent restitution in the year of receipt, the existence of this legal obligation cannot alter

the fact that the miscreant enjoys, in that accounting period, the economic use and benefit of his ill-gotten gain.

Nor can embezzled funds be likened to the proceeds of a loan. In the case of a loan, the borrower unconditionally manifests and acknowledges his purpose, intention and liability to make repayment. The accession in his assets is accompanied by a corresponding increase in his liabilities, his actual "wealth" remaining the same. The embezzler, on the other hand, treats the funds as his own, and neither acknowledges nor assents to the *in invitum* duty of repayment. He has, as a practical matter, the increase in resources, the "accession to wealth", which no borrower enjoys. The economic aspects of the transactions, which under the statute dominate in the inquiry into gross income, are vitally different.[6] The embezzler's "accession to wealth" is, from an economic standpoint, subject to diminution only to the extent, if any, that he is compelled to make restitution, as the case at bar aptly illustrates. As shown in the Statement (*supra*, pp. 9-10), while petitioner misappropriated about three-quarters of a million dollars during the tax period (1951 to 1954), it was not until 1958 that he was re-

[6] On the deduction side, from the lender's point of view the statute itself recognizes this difference. The lender's taxable income is not reduced by loans made. Only when the loan becomes worthless is a deduction permissible for, until then, the value of the borrower's obligation to repay compensates for the outgo of resources. The victim of embezzlement, by contrast, reduces his income by the amount of the funds taken immediately upon discovery of the theft. His unsatisfied right of recovery from the embezzler normally has no value ascribed to it.

quired to make restitution, and then only in the amount of about $13,500. For all practical purposes, *i.e.*, so far as "readily realizable economic benefit" was concerned, he was as much the "owner" of the money, during the tax years in question, as if he had earned it lawfully—and it would be an extraordinary result, as this Court indicated in *Rutkin*, to accord a wrongdoer preferential tax treatment because his acquisition of the receipts was unlawful.

In summary on this point, apart from the case of *Commissioner* v. *Wilcox, supra,* to be discussed next, we submit that the controlling decisions of this Court compel the conclusion that embezzled funds are income, taxable in the year when received. If, when, and to the extent that the victim recovers back the misappropriated funds, there is of course a reduction in the embezzler's income. But the mere fact that the gain is unlawful, and that it is accompanied by a legal obligation to pay back the misappropriated funds to their rightful owners, does not in any way affect or impair the conclusion that the receipt of the gain and the enjoyment of the economic benefits represented thereby constitute taxable income.

II

SINCE THE *WILCOX* CASE REPRESENTED A DEPARTURE FROM FUNDAMENTAL PRINCIPLES FOR THE DETERMINATION OF GROSS INCOME, ITS REASONING HAS ALREADY BEEN REJECTED BY THE COURT, AND ITS HOLDING IS NO LONGER CONTROLLING ON THE ISSUE HERE

Thus, apart from *Commissioner* v. *Wilcox,* 327 U.S. 404, there is a long, consistent, and undeviating line of

authority establishing broad tests for determining taxability of gains, and that under these tests embezzled funds are clearly taxable income. The problem posed by the *Wilcox* decision, which stands for an opposite conclusion, is comparable to that presented in *Helvering* v. *Hallock*, 309 U.S. 106. There the Court rejected the notion that *stare decisis* is "a mechanical formula of adherence to the latest decision, however recent and questionable, when such adherence involves collision with a prior doctrine more embracing in its scope, intrinsically sounder, and verified by experience" (p. 119). The *Wilcox* case involves collision not only with prior but also with subsequent doctrine, and the Court's language in *Hallock* has even more forceful application here: "[W]e cannot evade our own responsibility for reconsidering in the light of further experience, the validity of distinctions which this Court has itself created. Our problem then is not that of rejecting a settled statutory construction. The real problem is whether a principle shall prevail over its later misapplications. Surely we are not bound by reason or by the considerations that underlie *stare decisis* to persevere in distinctions taken in the application of a statute which, on further examination, appear consonant neither with the purposes of the statute nor with this Court's own conception of it" (p. 122). See also *Girouard* v. *United States*, 328 U.S. 61, 69–70.

In *Wilcox* the Court held that because the embezzler asserted no bona fide legal or equitable claim to the proceeds and was under a definite unconditional obligation to repay them, and because they were there-

fore not received under a "claim of right," embezzled funds were not income. This reasoning is plainly irreconcilable with the many decisions of this Court marking the boundaries of taxable income, both before and after *Wilcox*. See the cases cited *supra*, pp. 14–21. We think it plain that no logical distinction can be drawn for present purposes between the fruits of embezzlement and extortion. It can hardly be disputed now that had the Court in *Rutkin* applied the claim of right test of *Wilcox* it would have had to reach the same result as in *Wilcox*, for an extortioner acquires no more bona fide legal or equitable claim of right to his ill-gotten gain than does an embezzler. Conversely, had the Court in *Wilcox* applied the economic use and benefit test laid down in earlier cases

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The adoption in *Wilcox* of a claim of right test as a touchstone of taxability had no support in prior precedents. What became known in the law of taxation as the "claim of right doctrine" had its genesis in *North American Oil* v. *Burnet*, 286 U.S. 417, cited by the Court in support of its ruling in *Wilcox*. It was by origin and definition a doctrine invoked by the Court in aid of the concept of annual accounting, to determine *when*, not whether, receipts constituted income. In *North American Oil* it was conceded that the receipts in controversy were income; the question before the Court was when the receipts, admittedly income, were to be reported. *Wilcox* was the first and only decision in which the Court applied claim of right as a substantive test of income. Moreover, the claim of right test of *Wilcox* was not even framed in the language of *North American Oil*.

Significantly, when the Court had occasion, subsequent to *Wilcox*, to invoke the claim of right concept—in cases involving assailable lawful gains—it reverted to the language of *North American Oil* and again regarded claim of right as a doctrine to be invoked in aid of the annual accounting concept. *United States* v. *Lewis*, 340 U.S. 590; *Healy* v. *Commissioner*, 345 U.S. 278.

and later followed in *Rutkin*, it would have had to reach the same result as in *Rutkin*, for, in dissipating the embezzled funds in gambling houses, Wilcox, as a practical matter, derived as much economic value from them as did Rutkin from the fruits of his extortion.

The Court in *Rutkin* did not seek to distinguish *Wilcox* on the ground that, while the embezzler obtains no title to the funds taken, the extortionist obtains a defeasible title. And the concomitant difference under state law in the cause of action for restitution accruing to the victim of each (based upon the contrast between void and voidable transactions) was not relied upon.* These differences did not control because such technical refinements do not determine what is or is not taxable income. So far as economic benefit and enjoyment—the controlling considerations—are concerned, the positions of the extortionist and the embezzler are alike.

Instead of attempting to accept the *Wilcox* rationale, but at the same time holding it inapplicable be-

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* *Wilcox* did not clarify the nature of the "unconditional" obligation to repay which prevents inclusion of the receipt in income. The extortionist's liability to his victim seems hardly the less unconditional because the victim when suing for recovery may be required in his complaint to disavow the transaction. The payee of usurious interest or other fees violative of statute may be absolutely liable to the payor for repayment. One who receives a payment by reason of mistake of law or fact or other circumstances causing "unjust enrichment" depending on the jurisdiction may be in a similar position. And the agent who receives a bribe or kickback is liable, not to the third person who paid him, but to his principal for the full amount. Are these instances of an "unconditional obligation to repay" within *Wilcox*? All these questions, which can be consistently settled under the *Rutkin* criteria, invite litigation and divergent results under *Wilcox*.

cause of the differences in the two situations—a course which we believe would not have withstood legal analysis—the Court in *Rutkin*, without even referring to the *Wilcox* rationale, chose instead to follow the general principles, wholly dissimilar from *Wilcox*, declared and applied in the numerous decisions discussed earlier. "We limit that case [*Wilcox*] to its facts," declared the Court in *Rutkin*, 343 U.S. at 138. And the dissenters expressly stated their understanding that the majority had rejected the *Wilcox* interpretation of Section 22(a). *Id.* at 140.

In sum, under the basic principles of income taxation established by the Court, embezzled funds are income; moreover, in the long exegesis of Section 22(a) found in numerous decisions, the reasoning of *Wilcox*, the only case which today would support a contrary holding, has been deliberately left devoid of precedential authority. True, *Wilcox* was not expressly overruled in *Rutkin*. But the Court was neither asked nor did it find the occasion or the necessity for doing so. Here, however, the issue is squarely presented whether, by necessary implication, this Court in *Rutkin* overruled *Wilcox*. We think it clearly did.

Recognizing the departure from fundamental principles represented by the reasoning of the *Wilcox* decision, even prior to *Rutkin* the lower federal courts had proceeded to distinguish *Wilcox*, giving it the most narrow scope and application. See, *e.g.*, *United States* v. *Chapman*, 168 F. 2d 997 (C.A. 7th); *Akers* v. *Scofield*, 167 F. 2d 718 (C.A. 5th), certiorari denied, 335 U.S. 823; *Currier* v. *United States*, 166 F. 2d 346

(C.A. 1st), affirming 70 F. Supp. 219 (D. Mass.); *Cutcliffe* v. *Commissioner,* 163 F. 2d 891 (C.A. 5th), affirming the decision of July 31, 1946 (1946 P-H T.C. Memorandum Decisions, par. 46,184); *United States* v. *Iozia,* 104 F. Supp. 846 (S.D.N.Y.); *Petit* v. *Commissioner,* 10 T.C. 1253.

Since *Rutkin,* the courts of appeals with one exception, have applied the *Rutkin* rule that unlawful gains are taxable income, treating *Wilcox* as in effect having been overruled by *Rutkin.* Thus, in *Macias* v. *Commissioner,* 255 F. 2d 23, 26 (C.A. 7th), the court stated:

> If * * * [the rule of the *Rutkin* case] had been employed in *Wilcox,* we see no escape from the conclusion that the decision in that case would have been different. In our view the Court in *Rutkin* repudiated its holding in *Wilcox;* certainly it repudiated the reasoning by which the result was reached in that case. * * *

In *Briggs* v. *United States,* 214 F. 2d 699, 702 (C.A. 4th), certiorari denied, 348 U.S. 864, the Fourth Circuit observed that "the effect of the doctrine laid down * * * [in *Rutkin*] was 'to depart from the *Wilcox* holding' ". The economic use and benefit test of *Rutkin* has been applied to all unlawful gains, however acquired, including embezzled or misappropriated receipts, with the exception to be noted. *E.g., Prokop* v. *Commissioner,* 254 F. 2d 544 (C.A. 7th) (funds misappropriated from a labor union by an employee of the union); *Briggs* v. *United States, supra* (funds withheld by an employee from the proceeds of sales of property belonging to his employer); *United States*

v. *Wyss*, 239 F. 2d 658 (C.A. 7th) (kickbacks received for procuring transactions with a municipality); *United States* v. *Bruswitz*, 219 F. 2d 59 (C.A. 2d), certiorari denied, 349 U.S. 913 (commercial bribes of money extracted by an employee for the privilege of doing business with his employer); *Davis* v. *United States*, 226 F. 2d 331 (C.A. 6th), certiorari denied, 350 U.S. 965 (funds diverted from corporations by officer stockholder); *Berra* v. *United States*, 221 F. 2d 590 (C.A. 8th), affirmed without discussion of the point, 351 U.S. 131 (kickbacks received by business manager of labor union pursuant to collusive agreement with contractor doing work for the union). In each of the cases cited, the defendants contended that their conduct amounted to embezzlement under state law, and that therefore under *Wilcox* their illicit gains were non-taxable. The *Rutkin* rule was nevertheless applied.* The one exception, a split decision of the Second Circuit, *J. J. Dix, Inc.* v. *Commissioner*, 223 F. 2d 436, 438, certiorari denied, 350 U.S. 894, determined that because the case was "not one involving a receipt under any color of right" the facts brought it closer to *Wilcox* than to *Rutkin* and applied the former decision. For reasons already stated, we think the court's failure there to apply the *Rutkin* decision was error. Generally, however, the Tax Court and the district courts

* Many of these cases illustrate the artificial distinctions to which the lower courts resorted to avoid the impact of the *Wilcox* holding.

have applied the criteria of *Rutkin* rather than that of *Wilcox* to cases of unlawful gains.[10]

Thus, our views as to the effect of *Rutkin* are supported by the opinions of the vast majority of courts which have considered the matter. Virtually all lower courts which have passed upon the question, extrapolating from the decisions of this Court the basic economic benefit test for taxable income, have applied it to a miscellaneous array of unlawful gains and held them all income. In doing so, we think the lower courts have correctly applied *Rutkin*. In our view the rule of the *Rutkin* case is applicable to all gains, however acquired, lawful or unlawful. If this Court were now to revitalize *Wilcox* it would be declaring, in effect, that those cases were decided wrongly and that the gains from such illicit activities were tax exempt. Moreover, a reversion to *Wilcox* could, so far as gains from lawful activities are concerned, becloud the authority and applicability of the comprehensive definition of taxable income evolved in the decision of this Court. But the

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[10] See *e.g.*, *Boucher* v. *Commissioner*, 18 T.C. 710; *Estate of Simmons* v. *Commissioner*, 26 T.C. 409; *Leaf* v. *Commissioner*, 33 T.C.—(No. 125); *Federbush* v. *Commissioner*, 34 T.C.—(No. 77). Indeed, the decision upon which petitioner relies in *United States* v. *Green* (D. Mass.), decided March 31, 1959, where Judge Wyzanski directed an acquittal based upon the *Wilcox* decision, is no longer adhered to by that judge. In a subsequent case Judge Wyzanski declined to follow his *Green* decision, observing "I erred in that case. * * * [It] is quite apparent that my ruling was erroneous * * * I am not going to follow it." *United States* v. *Thomas Worcester* (D. Mass.), Cr. Nos. 57-62W, 57-63W, a prosecution for tax evasion. The quotation is from the court reporter's transcript of proceedings had in the case on August 30, 1960.

Court has made it unmistakably clear that assailable unlawful gains are to be treated no differently than assailable lawful gains, *Rutkin*, at pp. 137–138.[11]

Wilcox and *Rutkin* cannot be reconciled on the basis of asserted technical differences between the extortionist and the embezzler. To do so would be to draw, for tax purposes, unreal distinctions among those whose receipts come from illegal sources. And such a disposition would doubtless inaugurate a new series of attempts by taxpayers, in both civil and criminal cases, to characterize their activities as embraced

[11] Prior to the *Wilcox* decision, the only pertinent administrative material, a General Counsel's Memorandum No. 16572, XV–1 Cum. Bull. 82, which was published in 1936, had held that embezzled funds were taxable gains. Subsequent to *Wilcox*, G.C.M. No. 24945, 1946–2 Cum. Bull. 27, commented that the earlier memorandum was "too broad inasmuch as that memorandum can be construed as holding that embezzlement results in taxable income in all cases", indicated that the "mere act of embezzlement does not of itself result in taxable income", but suggested that "where the owner condones the taking of the property and forgives the indebtedness, taxable income may result to the embezzler, depending on the facts in the particular case." Thus the Internal Revenue Service attempted to construe *Wilcox* narrowly. The failure of the Commissioner expressly to revoke or modify this ruling after the *Rutkin* decision cannot be relied upon by petitioner as showing any administrative "acceptance" of the rationale of *Wilcox*. Obviously, any decision of this Court, to the extent applicable, supersedes a prior General Counsel's Memorandum. The *Rutkin* decision was published in 1952–1 Cum. Bull. 9. Decisions are published in the Cum. Bull. when, among other circumstances, they "revoke, modify, amend, or affect in any manner whatever any published ruling or decision." See Cautionary Notice, 1952–1 Cum. Bull. at page I.

within the varying embezzlement statutes found in the states.[12]

The proper course, we submit, which is consonant with this Court's major decisions in the field of taxation and the one anticipated by virtually every lower court to consider the issue, is to recognize that the *Wilcox* rationale was rejected in *Rutkin*, is unsound, and can no longer be regarded as having vitality. Embezzled funds represent taxable gains. Clear and uniform in its application, the rule of *Rutkin* produces no inequities as between the tax burden borne by lawful and unlawful activities; nor does it propel the federal courts into the labyrinth of varied state concepts of embezzlement. A logical culmination of basic principles, it is sound and should be reaffirmed.

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[12] The task which might then be imposed upon the federal courts can best be comprehended from the following: "Embezzlement is a statutory and not a common-law offense. The statutes vary so much in the different jurisdictions that it is impossible to frame a definition that will apply in all." Clark & Marshall, *Crimes*, p. 796 (6th ed. 1958).

CONCLUSION

For the reasons stated, the judgment below should be affirmed.

Respectfully submitted.

J. LEE RANKIN,
Solicitor General.
CHARLES K. RICE,
Assistant Attorney General.
HOWARD A. HEFFRON,
Assistant Deputy Attorney General.
MEYER ROTHWACKS,
JOHN J. MCGARVEY,
Attorneys.

NOVEMBER 1960.

U. S. GOVERNMENT PRINTING OFFICE: 1960

SUPREME COURT OF THE UNITED STATES

No. 63.—October Term, 1960.

Eugene C. James, Petitioner, v. United States.	On Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit.

[May 15, 1961.]

Mr. Chief Justice Warren announced the judgment of the Court and an opinion in which Mr. Justice Brennan, and Mr. Justice Stewart concur.

The issue before us in this case is whether embezzled funds are to be included in the "gross income" of the embezzler in the year in which the funds are misappropriated under § 22 (a) of the Internal Revenue Code of 1939 [1] and § 61 (a) of the Internal Revenue Code of 1954.[2]

The facts are not in dispute. The petitioner is a union official who, with another person, embezzled in excess of $738,000 during the years 1951 through 1954 from his employer union and from an insurance company with which the union was doing business.[3] Petitioner failed

[1] § 22. Gross Income.

"(a) *General Definition.*—'Gross income' includes gains, profits, and income derived from salaries, wages, or compensation for personal service . . . of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership of use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. . . ." (26 U. S. C. (1952 ed.) § 22 (a).)

[2] § 61. Gross Income Defined.

"(a) *General Definition.*—Except as otherwise provided in this subtitle, gross income means all income from whatever source derived. . . ." (26 U. S. C. § 61 (a).)

[3] Petitioner has pleaded guilty to the offense of conspiracy to embezzle in the Court of Essex County, New Jersey.

to report these amounts in his gross income in those years and was convicted for willfully attempting to evade the federal income tax due for each of the years 1951 through 1954 in violation of § 145 (b) of the Internal Revenue Code of 1939 [4] and § 7201 of the Internal Revenue Code of 1954.[5] He was sentenced to a total of three years imprisonment. The Court of Appeals affirmed. 273 F. 2d 5. Because of a conflict with this Court's decision in *Commissioner* v. *Wilcox*, 327 U. S. 404, a case whose relevant facts are concededly the same as those in the case now before us, we granted certiorari. 362 U. S. 974.

In *Wilcox*, the Court held that embezzled money does not constitute taxable income to the embezzler in the year of the embezzlement under § 22 (a) of the Internal Revenue Code of 1939. Six years later, this Court held, in *Rutkin* v. *United States*, 343 U. S. 130, that extorted money does constitute taxable income to the extortionist in the year that the money is received under § 22 (a) of

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[4] § 145. Penalties.

"(b) *Failure to Collect and Pay Over Tax, or Attempt to Defeat Tax.*—Any person required under this chapter to collect, account for, and pay over any tax imposed by this chapter, who willfully fails to collect or truthfully account for and pay over such tax, and any person who willfully attempts in any manner to evade or defeat any tax imposed by this chapter or the payment thereof, shall, in addition to other penalties provided by law, be guilty of a felony and, upon conviction thereof, be fined not more than $10,000 or imprisoned for not more than five years, or both, together with the costs of prosecution." (26 U. S. C. (1952 ed.) § 145 (b).)

[5] § 7201. Attempt to Evade or Defeat Tax.

"Any person who willfully attempts in any manner to evade or defeat any tax imposed by this title or the payment thereof shall, in addition to other penalties provided by law, be guilty of a felony and, upon conviction thereof, shall be fined not more than $10,000 or imprisoned not more than 5 years, or both, together with the costs of prosecution." (26 U. S. C. § 7201.)

the Internal Revenue Code of 1939. In *Rutkin*, the Court did not overrule *Wilcox*, but stated:

> "We do not reach in this case the factual situation involved in *Commissioner* v. *Wilcox*, 327 U. S. 404. We limit that case to its facts. There embezzled funds were held not to constitute taxable income to the embezzler under § 22 (a)." *Id.*, at 138.[6]

However, examination of the reasoning used in *Rutkin* leads us inescapably to the conclusion that *Wilcox* was thoroughly devitalized.

The basis for the *Wilcox* decision was "that a taxable gain is conditioned upon (1) the presence of a claim of right to the alleged gain and (2) the absence of a definite, unconditional obligation to repay or return that which would otherwise constitute a gain. Without some bona fide legal or equitable claim, even though it be contingent or contested in nature, the taxpayer cannot be said to have received any gain or profit within the reach of § 22 (a)." *Commissioner* v. *Wilcox*, *supra*, at p. 408. Since Wilcox embezzled the money, held it "without any semblance of a bona fide claim of right," *ibid.*, and therefore "was at all times under an unqualified duty and obligation to repay the money to his employer," *ibid.*, the Court found that the money embezzled was not includible within "gross income." But, Rutkin's legal claim was no greater than that of Wilcox. It was specifically found "that petitioner had no basis for his claim . . . and that he obtained it by extortion." *Rutkin* v. *United States*, *supra*, at p. 135. Both Wilcox and Rutkin obtained the money by means of a criminal act; neither had a bona fide claim of right to the funds.[7] Nor was Rutkin's obligation

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[6] The dissenters in *Rutkin* stated that the Court had rejected the *Wilcox* interpretation of § 22 (a). *Id.*, at 140.

[7] The Government contends that the adoption in *Wilcox* of a claim of right test as a touchstone of taxability had no support in the prior

to repay the extorted money to the victim any less than that of Wilcox. The victim of an extortion, like the victim of an embezzlement, has a right to restitution. Furthermore, it is inconsequential that an embezzler may lack title to the sums he appropriates while an extortionist may gain a voidable title. Questions of federal income taxation are not determined by such "attenuated subleties." *Lucas* v. *Earle*, 281 U. S. 111, 114; *Corliss* v. *Bowers*, 281 U. S. 376, 378. Thus, the fact that Rutkin secured the money with the consent of his victim, *Rutkin* v. *United States*, *supra*, at p. 138, is irrelevant. Likewise unimportant is the fact that the sufferer of an extortion is less likely to seek restitution than one whose funds are embezzled. What is important is that the right to recoupment exists in both situations.

Examination of the relevant cases in the courts of appeals lends credence to our conclusion that the *Wilcox* rationale was effectively vitiated by this Court's decision in *Rutkin*.[8] Although this case appears to be the first to

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cases of this Court; that the claim of right test was a doctrine invoked by the Court in aid of the concept of annual accounting, to determine *when*, not *whether*, receipts constituted income. See *North American Oil Co.* v. *Burnet*, 286 U. S. 417; *United States* v. *Lewis*, 340 U. S. 590; *Healy* v. *Commissioner*, 345 U. S. 278. In view of our reasoning set forth below, we need not pass on this contention. The use to which we put the claim of right test here is only to demonstrate that, whatever its validity as a test of *whether* certain receipts constitute income, it calls for no distinction between *Wilcox* and *Rutkin*.

[8] In *Marienfeld* v. *United States*, 214 F. 2d 632, the Eighth Circuit stated, "We find it difficult to reconcile the Wilcox case with the later opinion of the Supreme Court in Rutkin. . . ." *Id.*, at 636. The Second Circuit announced, in *United States* v. *Bruswitz*, 219 F. 2d 59, "It is difficult to perceive what, if anything, is left of the Wilcox holding after Rutkin . . . ." *Id.*, at 61. The Seventh Circuit's prior decision in *Macias* v. *Commissioner*, 255 F. 2d 23, observed, "If this reasoning [of *Rutkin*] had been employed in Wilcox, we see no escape from the conclusion that the decision in that case would have been

arise that is "on all fours" with *Wilcox*, the lower federal courts, in deference to the undisturbed *Wilcox* holding, have earnestly endeavored to find distinguishing facts in the cases before them which would enable them to include sundry unlawful gains within "gross income."[9]

It had been a well-established principle, long before either *Rutkin* or *Wilcox*, that unlawful, as well as lawful, gains are comprehended within the term "gross income." Section II B of the Income Tax Act of 1913 provided that, "the net income of a taxable person shall include gains, profits, and income . . . from . . . the transaction of any *lawful* business carried on for gain or profit; or gains or profits and income, derived from any source whatever. . . ." (Emphasis supplied.) 38 Stat. 167. When the statute was amended in 1916, the one word "lawful" was omitted. This revealed, we think, the obvious intent of that Congress to tax income derived from both legal and illegal sources, to remove the incongruity of having the gains of the honest laborer taxed and the gains of the dishonest immune. *Rutkin* v. *United States*, *supra*, at p. 138; *United States* v. *Sullivan*, 274 U. S. 259, 263.

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different. In our view, the Court in Rutkin repudiated its holding in Wilcox; certainly it repudiated the reasoning by which the result was reached in that case." *Id.*, at 26.

[9] For example, *Kann* v. *Commissioner*, 210 F. 2d 247, was differentiated on the following grounds: the taxpayer was never indicted or convicted of embezzlement; there was no adequate proof that the victim did not forgive the misappropriation; the taxpayer was financially able to both pay the income tax and make restitution; the taxpayer would have likely received most of the misappropriated money as dividends. In *Marienfeld* v. *United States*, *supra*, the court believed that the victim was not likely to repudiate. In *United States* v. *Wyss*, 239 F. 2d 658, the distinguishing factors were that the district judge had not found as a fact that the taxpayer embezzled the funds and the money had not as yet been reclaimed by the victim. See also *Briggs* v. *United States*, 214 F. 2d 699, 702; *Prokop* v. *Commissioner*, 254 F. 2d 544, 554–555. Cf. *J. J. Dix, Inc.*, v. *Commissioner*, 223 F. 2d 436.

Thereafter, the Court held that gains from illicit traffic in liquor are includible within "gross income." *Ibid.* See also *Johnson* v. *United States*, 318 U. S. 189; *United States* v. *Johnson*, 319 U. S. 503. And the Court has pointed out, with approval, that there has been a widespread and settled administrative and judicial recognition of the taxability of unlawful gains of many kinds." *Rutkin* v. *United States*, *supra*, at p. 137. These include protection payments made to racketeers, ransom payments paid to kidnappers, bribes, money derived from the sale of unlawful insurance policies, graft, black market gains, funds obtained from the operation of lotteries, income from race track bookmaking and illegal prize fight pictures. *Ibid.*

The starting point in all cases dealing with the question of the scope of what is included in "gross income" begins with the basic premise that the purpose of Congress was "to use the full measure of its taxing power." *Helvering* v. *Clifford*, 309 U. S. 331, 334. And the Court has given a liberal construction to the broad phraseology of the "gross income" definition statutes in recognition of the intention of Congress to tax all gains except those specifically exempted. *Commissioner* v. *Jacobson*, 336 U. S. 28, 49; *Helvering* v. *Stockholms Enskilda Bank*, 293 U. S. 84, 87–91. The language of § 22 (a) of the 1939 Code, "gains or profits and income derived from any source whatever," and the more simplified language of § 61 (a) of the 1954 Code, "all income from whatever source derived," has been held to encompass all "accessions to wealth, clearly realized, and over which the taxpayers have complete dominion." *Commissioner* v. *Glenshaw Glass Co.*, 348 U. S. 426, 431. A gain "constitutes taxable income when its recipient has such control over it that, as a practical matter, he derives readily realizable economic value from it." *Rutkin* v. *United States*, *supra*, at p. 137. Under these broad principles, we believe that petitioner's contention, that all unlawful gains are tax-

able except those resulting from embezzlement, should fail.

When a taxpayer acquires earnings, lawfully or unlawfully, without the consensual recognition, express or implied, of an obligation to repay and without restriction as to their disposition, "he has received income which he is required to return, even though it may still be claimed that he is not entitled to retain the money, and even though he may still be adjudged liable to restore its equivalent." *North American Oil* v. *Burnet*, *supra*, at p. 424. In such case, the taxpayer has "actual command over the property taxed—the actual benefit for which the tax is paid." *Corliss* v. *Bowers*, *supra*. This standard brings wrongful appropriations within the broad sweep of "gross income"; it excludes loans. When a law-abiding taxpayer mistakenly receives income in one year, which receipt is assailed and found to be invalid in a subsequent year, the taxpayer must nonetheless report the amount as "gross income" in the year received. *United States* v. *Lewis*, *supra*; *Healy* v. *Commissioner*, *supra*. We do not believe that Congress intended to treat a law-breaking taxpayer differently. Just as the honest taxpayer may deduct any amount repaid in the year in which the repayment is made, the Government points out that, "if, when, and to the extent that the victim recovers back the misappropriated funds, there is of course a reduction in the embezzler's income." Brief for the United States, p. 24.[10]

[10] Petitioner urges upon us the case of *Alison* v. *United States*, 344 U. S. 167. But, that case dealt with the right of the victim of an embezzlement to take a deduction, under § 23 (e) and (f) of the 1939 Code, in the year of the discovery of the embezzlement rather than the year in which the embezzlement occurred. The Court held only "that the special factual circumstances found by the District Courts in both these cases justify deductions under I. R. C. § 23 (e) and (f) and the long-standing Treasury Regulations applicable to embezzlement losses." *Id.*, at 170. The question of inclusion of embezzled funds in "gross income" was not presented in *Alison*.

Petitioner contends that the *Wilcox* rule has been in existence since 1946; that if Congress had intended to change the rule, it would have done so; that there was a general revision of the income tax laws in 1954 without mention of the rule; that a bill to change it [11] was introduced in the Eighty-sixth Congress but was not acted upon; that, therefore, we may not change the rule now. But the fact that Congress has remained silent or has re-enacted a statute which we have construed, or that congressional attempts to amend a rule announced by this Court have failed do not necessarily debar us from re-examining and correcting the Court's own errors. *Girouard* v. *United States*, 328 U. S. 61, 69–70; *Helvering* v. *Hallock*, 309 U. S. 106, 119–122. There may have been any number of reasons why Congress acted as it did. *Helvering* v. *Hallock*, *supra*. One of the reasons could well be our subsequent decision in *Rutkin* which has been thought by many to have repudiated *Wilcox*. Particularly might this be true in light of the decisions of the Courts of Appeals which have been riding a narrow rail between the two cases and further distinguishing them to the disparagement of *Wilcox*. See notes 8 and 9, *supra*.

We believe that *Wilcox* was wrongly decided and we find nothing in congressional history since then to persuade us that Congress intended to legislate the rule. Thus, we believe that we should now correct the error and the confusion resulting from it, certainly if we do so in a manner that will not prejudice those who might have relied on it. Cf. *Helvering* v. *Hallock*, *supra*, at 119. We should not continue to confound confusion, particularly when the result would be to perpetuate the injustice of relieving embezzlers of the duty of paying income taxes on the money they enrich themselves with through theft while honest people pay their taxes on every conceivable type of income.

[11] H. R. 8854, 86th Cong., 1st Sess.

But, we are dealing here with a felony conviction under statutes which require that petitioner "willfully" fails to account for his tax or that he "willfully" attempts to evade his obligation. In *Spies* v. *United States*, 317 U. S. 492, 499, the Court said that § 145 (b) of the 1939 Code embodied "the gravest of offenses against the revenues," and stated that willfulness must therefore include an evil motive and want of justification in view of all the circumstances. *Id.*, at 498. Willfulness "involves a specific intent which must be proven by independent evidence and which cannot be inferred from the mere understatement of income." *Holland* v. *United States*, 348 U. S. 121, 139.

We believe that the element of willfulness could not be proven in a criminal prosecution for failing to include embezzled funds in gross income in the year of misappropriation so long as the statute contained the gloss placed upon it by *Wilcox* at the time the alleged crime was committed. Therefore, we feel that petitioner's conviction may not stand and that the indictment against him must be dismissed.

Since MR. JUSTICE HARLAN, MR. JUSTICE FRANKFURTER, and MR. JUSTICE CLARK agree with us concerning *Wilcox*, that case is overruled. MR. JUSTICE BLACK, MR. JUSTICE DOUGLAS, and MR. JUSTICE WHITTAKER believe that petitioner's conviction must be reversed and the case dismissed for the reasons stated in their opinions.

Accordingly, the judgment of the Court of Appeals is reversed and the case is remanded to the District Court with directions to dismiss the indictment.

It is so ordered.

SUPREME COURT OF THE UNITED STATES

No. 63.—October Term, 1960.

Eugene C. James, Petitioner, v. United States.	On Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit.

[May 15, 1961.]

Mr. Justice Black, whom Mr. Justice Douglas joins, concurring in part and dissenting in part.

On February 25, 1946, fifteen years ago, this Court, after mature consideration, and in accordance with what at that time represented the most strongly supported judicial view, held, in an opinion written by Mr. Justice Murphy to which only one Justice dissented, that money secretly taken by an embezzler for his own use did not constitute a taxable gain to him under the federal income tax laws. *Commissioner* v. *Wilcox*, 327 U. S. 404. The Treasury Department promptly accepted this ruling in a bulletin declaring that the "mere act of embezzlement does not of itself result in taxable income," although properly urging that "taxable income may result to the embezzler, depending on the facts in the particular case."[1] During the fifteen years since *Wilcox* was decided, both this Court and Congress, although urged to do so, have declined to change the *Wilcox* interpretation of statutory

[1] G. C. M. No. 24945, 1946-2 Cum. Bull. 27, 28. This was precisely in accord with this Court's statement of the proper rule in the *Wilcox* opinion:

"Taxable income may arise, to be sure, from the use or in connection with the use of such [embezzled] property. But apart from such factors the bare receipt of property or money wholly belonging to another lacks the essential characteristics of a gain or profit within the meaning of § 22 (a)." 327 U. S. at 408.

"income" with respect to embezzlement. In this case however, a majority of the Court overrules *Wilcox*. Only three of the members of the Court who decided the *Wilcox* case are participating in this case—MR. JUSTICE FRANKFURTER, MR. JUSTICE DOUGLAS, and myself. MR. JUSTICE DOUGLAS and I dissent from the Court's action in "overruling" *Wilcox* and from the prospective way in which this is done. We think *Wilcox* was sound when written and is sound now.

I.

We dissent from the way the majority of the Court overrules *Wilcox*. If the statutory interpretation of "taxable income" in *Wilcox* is wrong, then James is guilty of violating the tax evasion statute for the trial court's judgment establishes that he embezzled funds and wilfully refrained from reporting them as income. It appears to us that District Courts are bound to be confused as to what they can do hereafter in tax-evasion cases involving "income" from embezzlements committed prior to this day. Three Justices vote to overrule *Wilcox* under what we believe to be a questionable formula, at least a new one in the annals of this Court, and say that although failure to report embezzled funds has, despite *Wilcox*, always been a crime under the statute, people who have violated this law in the past cannot be prosecuted but people who embezzle funds after this opinion is announced can be prosecuted for failing to report these funds as a "taxable gain." Three other Justices who vote to overrule *Wilcox* say that past embezzlers can be prosecuted for the crime of tax evasion although two of those Justices believe the Government must prove that the past embezzler did not commit his crime in reliance on *Wilcox*. Thus, although it was not the law yesterday, it will be the law tomorrow that funds embezzled hereafter are taxable income; and although past embezzlers could not have

been prosecuted yesterday, maybe they can and maybe they cannot be prosecuted tomorrow for the crime of tax evasion. (The question of the civil tax liability of past embezzlers is left equally unclear.) We do not challenge the wisdom of those of our Brethren who refuse to make the Court's new tax evasion crime applicable to past conduct. This would be good governmental policy even though the *ex post facto* provision of the Constitution has not ordinarily been thought to apply to judicial legislation. Our trouble with this aspect of the Court's action is that it seems to us to indicate that the Court has passed beyond the interpretation of the tax statute and proceeded substantially to amend it.

We realize that there is a doctrine with wide support to the effect that under some circumstances courts should make their decisions as to what the law is apply only prospectively.[2] Objections to such a judicial procedure, however, seem to us to have peculiar force in the field of criminal law. In the first place, a criminal statue that is so ambiguous in scope that an interpretation of it brings about totally unexpected results, thereby subjecting people to penalties and punishments for conduct which they could not know was criminal under existing law, raises serious questions of unconstitutional vagueness.[3] Moreover, for a court to interpret a criminal statute in such a way as to make punishment for past conduct under it so unfair and unjust that the interpretation should be given only prospective application seems to us to be the creation of a judicial crime that Congress might not want to create. This country has never been sympathetic with judge-created crimes. Their rejection under our Constitution was said to have been "long since settled in public

[2] See, for example, *Great Northern R. Co.* v. *Sunburst Oil Co.*, 287 U. S. 358.

[3] See, for example, *United States* v. *L. Cohen Grocery Co.*, 255 U. S. 81.

opinion" even as early as 1812 when the question first reached this Court in *United States* v. *Hudson & Goodwin*, 7 Cranch 32. In that case this Court emphatically declared that the federal courts have no common-law jurisdiction in criminal cases. They are not "vested with jurisdiction over any particular act done by an individual in supposed violation of the peace and dignity of the sovereign power." Rather, "[t]he legislative authority of the Union must first make an act a crime, affix a punishment to it, and declare the Court that shall have jurisdiction of the offence."[4]

In our judgment one of the great inherent restraints upon this Court's departure from the field of interpretation to enter that of lawmaking has been the fact that its judgments could not be limited to prospective application. This Court and in fact all departments of the Government have always heretofore realized that prospective lawmaking is the function of Congress rather than of the courts. We continue to think that this function should be exercised only by Congress under our constitutional system.

II.

We think *Wilcox* was right when it was decided and is right now. It announced no new, novel doctrine. One need only look at the Government's briefs in this Court in the *Wilcox* case to see just how little past judicial support could then be mustered had the Government sought to send Wilcox to jail for his embezzlement under the guise of a tax evasion prosecution. The Government did cite many cases from many courts saying that under the federal income tax law gains are no less taxable because they have been acquired by illegal methods. This Court had properly held long before *Wilcox* that there is no "reason why the fact that a business is unlawful should

[4] 7 Cranch, at 34. And see *United States* v. *Coolidge*, 1 Wheat. 415.

exempt it from paying the taxes that if lawful it would have to pay."[5] We fully recognized the correctness of that holding in *Wilcox:*

> "Moral turpitude is not a touchstone of taxability. The question, rather, is whether the taxpayer in fact received a statutory gain, profit or benefit. That the taxpayer's motive may have been reprehensible or the mode of receipt illegal has no bearing upon the application of § 22 (a)."[6]

The Court today by implication attributes quite a different meaning or consequence to the *Wilcox* opinion. One opinion argues at length the "well-established principle . . . that unlawful, as well as lawful, gains are comprehended within the term 'gross income.'"[7] *Wilcox* did not deny that; we do not deny that. This repeated theme of our Brethren is wholly irrelevant since the *Wilcox* holding in no way violates the sound principle of treating "gains" of honest and dishonest taxpayers alike. The whole basis of the *Wilcox* opinion was that an embezzlement is not in itself "gain" or "income" to the embezzler within the tax sense, for the obvious reason that the embezzled property still belongs, and is known to belong, to the rightful owner. It is thus a mistake to argue that petitioner's contention is "that all unlawful gains are taxable except those resulting from embezzlement."

As stated in *Wilcox*, that case was brought to us because of a conflict among the Circuits. The Ninth Circuit in *Wilcox* had held that embezzled funds were not any more "taxable income" to the embezzler than borrowed funds would have been.[8] The Fifth Circuit, in *McKnight* v. *Commissioner*, had decided the same thing.[9]

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[5] *United States* v. *Sullivan*, 274 U. S. 259, 263.
[6] 327 U. S., at 408.
[7] *Wilcox* v. *Commissioner*, 148 F. 2d 933.
[8] 127 F. 2d 572.

The Eighth Circuit, however, had decided in *Kurrle* v. *Helvering* that embezzled funds were taxable income.[9] Comparison of the three opinions readily shows that the arguments of the Fifth and Ninth Circuits against taxability of such funds were much stronger than the arguments of the Eighth Circuit for such taxability. The whole picture can best be obtained from the court's opinion in *McKnight* v. *Commissioner*, written by Judge Sibley, one of the ablest circuit judges of his time. He recognized that the taxpayer could not rely upon the unlawfulness of his business to defeat taxation if he had made a "gain" in that business. He pointed out, however, that the ordinary embezzler "got no title, void or voidable, to what he took. He was still in possession as he was before, but with a changed purpose. He still had no right nor color of right. He claimed none."[10] Judge Sibley's opinion went on to point out that the "first takings [of an embezzler] are, indeed, nearly always with the intention of repaying, a sort of unauthorized borrowing. It must be conceded that no gain is realized by borrowing, because of the offsetting obligation."[11] Approaching the matter from a practical standpoint, Judge Sibley also explained that subjecting the embezzled funds to a tax would amount to allowing the United States "a preferential claim for part of the dishonest gain, to the direct loss and detriment of those to whom it ought to be restored."[12] He was not willing to put the owner of funds that had been stolen in competition with the United States Treasury Department as to which one should have a preference to get those funds.

[9] 126 F. 2d 723.

[10] 127 F. 2d, at 573.

[11] *Ibid.* The same reasoning can be found in our opinion in *Alison* v. *United States*, 344 U. S. 167, 169–170.

[12] 127 F. 2d, at 574.

It seems to us that Judge Sibley's argument was then and is now unanswerable. The rightful owner who has entrusted his funds to an employee or agent has troubles enough when those funds are embezzled without having the Federal Government step in with its powerful claim that the embezzlement is a taxable event automatically subjecting part of those funds (still belonging to the owner) to the waiting hands of the Government's tax gatherer. We say part of the *owner's* funds because it is on the supposed "gain" from them that the embezzler is now held to be duty-bound to pay the tax and history probably records few instances of independently wealthy embezzlers who have had nonstolen assets available for payment of taxes.

There has been nothing shown to us on any of the occasions when we have considered this problem to indicate that Congress ever intended its income tax laws to be construed as imposing what is in effect a property or excise tax on the rightful owner's embezzled funds, for which the owner has already once paid income tax when he rightfully acquired them. In our view, the Court today does Congress a grave injustice by assuming that it has imposed this double tax burden upon the victim of an embezzlement merely because someone has stolen his money, particularly when Congress has refused requests that it do so. The owner whose funds have been embezzled has done nothing but entrust an agent with possession of his funds for limited purposes, as many of us have frequent occasion to do in the course of business or personal affairs. Ordinarily the owner is not, and has no reason to be, at all aware of an embezzlement until long after the first misuse occurs. If Congress ever did manifest an intention to select the mere fact of embezzlement as the basis for imposing a double tax on the owner, we think a serious question of confiscation in violation of the

Fifth Amendment would be raised. All of us know that with the strong lien provisions of the federal income tax law an owner of stolen funds would have a very rocky road to travel before he got back, without paying a good slice to the Federal Government, such funds as an embezzler who had not paid the tax might, perchance, not have dissipated. An illustration of what this could mean to a defrauded employer is shown in this very case by the employer's loss of some $700,000, upon which the Government claims a tax of $559,000.

It seems to be implied that one reason for overruling *Wilcox* is that a failure to hold embezzled funds taxable would somehow work havoc with the public revenue or discriminate against "honest" taxpayers and force them to pay more taxes. We believe it would be impossible to substantiate either claim. Embezzlers ordinarily are not rich people against whom judgments, even federal tax judgments can be enforced. Judging from the meager settlements that those defrauded were apparently compelled to make with the embezzlers in this very case, it is hard to imagine that the Treasury will be able to collect the more than $500,000 it claims. And certainly the *Wilcox* case does not seem to have been one in which the Government could have collected any great amount of tax. The employer's embezzled $11,000 there went up in gambling houses. The scarcity of cases involving alleged taxes due from embezzlers is another indication that the Government cannot expect to make up any treasury deficits with taxes collected from embezzlers and thieves, especially when the cost to the Government of investigations and court proceedings against suspected individuals is considered. And, as already indicated, to the extent that the Government could be successful in collecting some taxes from embezzlers, it would most likely do so at the expense of the owner whose money had been stolen.

It follows that, except for the possible adverse effect on rightful owners, the only substantial result that one can foresee from today's holding is that the Federal Government will, under the guise of a tax evasion charge, prosecute people for a simple embezzlement. But the Constitution grants power to Congress to get revenue not to prosecute local crimes. And if there is any offense which under our dual system of government is a purely local one which the States should handle, it is embezzlement or theft. The Federal Government stands to lose much money by trying to take over prosecution of this type of local offense. It is very doubtful whether the further congestion of federal court dockets to try such local offenses is good for the Nation, the States or the people. Here the embezzler has already pleaded guilty to the crime of embezzlement in a state court, although the record does not show what punishment he has received. Were it not for the novel formula of applying the Court's new law prospectively, petitioner would have to serve three years in federal prison in addition to his state sentence. This graphically illustrates one of the great dangers of opening up the federal tax statutes, or any others, for use by federal prosecutors against defendants who not only can be but are tried for their crimes in local state courts and punished there. If the people of this country are to be subjected to such double jeopardy and double punishment, despite the constitutional command against double jeopardy, it seems to us it would be far wiser for this Court to wait and let Congress attempt to do it.

III.

The *Wilcox* case was decided fifteen years ago. Congress has met every year since then. All of us know that the House and Senate Committees responsible for our tax laws keep a close watch on judicial rulings interpret-

ing the Internal Revenue Code. Each committee has one or more experts at its constant disposal. It cannot possibly be denied that these committees and these experts are, and have been, fully familiar with the *Wilcox* holding. When Congress is dissatisfied with a tax decision of this Court, it can and frequently does act very quickly to overturn it.[13] On one occasion such an overruling enactment was passed by both the House and Senate and signed by the President all within one day after the decision was rendered by this Court.[14] In 1954 Congress, after extended study, completely overhauled and recodified the Internal Revenue Code. The *Wilcox* holding was left intact. In the Eighty-sixth Congress and in the present Eighty-seventh Congress bills have been introduced to subject embezzled funds to income taxation.[15] They have not been passed. This is not an instance when we can say that Congress may have neglected to change the law because it did not know what

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[13] *E. g., Commissioner* v. *Smith*, 324 U. S. 177 (compensation through exercise of stock option), led to § 218 of the Revenue Act of 1950, adding § 130A to the 1939 Code; *Commissioner* v. *Tower*, 327 U. S. 280; *Lusthaus* v. *Commissioner*, 327 U. S. 293; and *Commissioner* v. *Culbertson*, 337 U. S. 733 (family partnerships), led to § 340 of the Revenue Act of 1951, adding § 191 to the 1939 Code; *United States* v. *Silk*, 331 U. S. 704 ("employees" for purpose of Social Security employment tax), led to P. Law No. 642, 80th Cong., 62 Stat. 438, amending several sections of the 1939 Code; *Commissioner* v. *Estate of Church*, 335 U. S. 632, and *Estate of Spiegel* v. *Commissioner*, 335 U. S. 701 (estate tax), led to P. Law No. 378, 81st Cong., § 7, 63 Stat. 891, 894, amending § 811 (c) of the 1939 Code; *Wilmette Park Dist.* v. *Campbell*, 338 U. S. 411 (amusement tax), led to § 402 of the Revenue Act of 1951, adding § 1701 (d) to the 1939 Code; *Commissioner* v. *Korell*, 339 U. S. 619 (amortization of bond premium), led to § 217 of the Revenue Act of 1950, amending § 125 (b)(1) of the 1939 Code.

[14] 46 Stat. 1516; see 74 Cong. Rec. 7078–7079, 7198–7199.

[15] H. R. 8854, 86th Cong., 1st Sess.; H. R. 312, 87th Cong., 1st Sess.

was going on in the courts or because it was not asked to do so, as was the case in *Helvering* v. *Hallock*.[16] Nor is this a case in which subsequent affirmative congressional action manifested a view inconsistent with our prior decision, as was true in *Girouard* v. *United States*.[17] What we have here instead is a case in which Congress has not passed bills that have been introduced to make embezzled funds taxable and thereby make failure to report them as income a federal crime. For this Court to hold under such circumstances that the inherent ambiguity of legislative inaction gives the Court license to repudiate the long-standing interpretation of the income tax statute and thereby bring additional conduct within the tax evasion criminal statute seems to us to be flagrantly violative of the almost universally accepted axiom that criminal statutes are narrowly and strictly construed. Our Brethren cite no precedent in which this or any other court in the English-speaking world has so deliberately overruled a long-standing prior interpretation of a statute in order to create a crime which up to that time did not exist.

This Court as well as Congress was fully apprised of the various criticisms made in some Courts of Appeals opinions and elsewhere against the *Wilcox* holding, yet it has likewise until today steadfastly refused to overrule that holding during these fifteen years. This has been in the face of the fact that the Government expressly urged

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[16] "To explain the cause of non-action by Congress when Congress itself sheds no light is to venture into speculative unrealities. Congress may not have had its attention directed to an undesirable decision; *and there is no indication that as to the* St. Louis Trust *cases it had*, even by any bill that found its way into a committee pigeon-hole." 309 U. S. 106, 119–120. (Emphasis supplied.)

[17] "This affirmative action taken by Congress in 1942 negatives any inference that otherwise might be drawn from its silence when it reenacted the oath in 1940." 328 U. S. 61, 70.

that we do so in 1955, nine years after *Wilcox* was decided and three years after the decision in *Rutkin* v. *United States*, 343 U. S. 130. On that occasion the Court of Appeals for the Second Circuit, speaking through Judge Frank for himself and Judge Medina, had held in the case of *J. J. Dix, Inc.*, v. *Commissioner* that embezzled funds were not taxable as income, relying wholly on the *Wilcox* decision.[18] Judge Hincks dissented, saying that if the facts of *Dix* were not enough to distinguish it from *Wilcox* he would not follow *Wilcox*. In urging us to grant certiorari, the Government said that the case presented a recurring problem in the administration of the income tax laws. One of the arguments the Government presented for overruling *Wilcox*, strange as it may seem, was that "[s]everal prosecutions have recently been authorized and are now pending in various District Courts, even though the disputed income in those cases apparently came from embezzlements or closely analogous crimes."[19] And the next to the last sentence of its petition was: "In short, the question whether the proceeds of embezzlement, unlike other illegal income, are to enjoy a preferred tax-exempt status, will continue to perplex the lower courts until it is settled by this Court."[20] We denied certiorari.[21] There is surely less reason to repudiate and "devitalize" *Wilcox* now, six years after the Court, as composed at that time, refused to overrule it.

Of course the rule of *stare decisis* is not and should not be an inexorable one. This is particularly true with reference to constitutional decisions involving determinations beyond the power of Congress to change, but Con-

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[18] 223 F. 2d 436.

[19] Petition for certiorari, *Commissioner* v. *Estate of Dix*, No. 363, October Term, 1955, p. 14, n. 6.

[20] *Id.*, at 15.

[21] 350 U. S. 894.

gress can and does change statutory interpretations. It is perfectly proper and right that it should do so when it believes that this Court's interpretation of a statute embodies a policy that Congress is against. But Congress has not taken favorable action on bills introduced to overturn our *Wilcox* holding even after we declined the Government's request to reverse the identical holding in *Dix*, the latter having occurred three years after the decision in *Rutkin* which our Brethren now say may have misled Congress into thinking that we had repudiated the *Wilcox* holding.

It seems to us that we gave the doctrine of *stare decisis* its proper scope in our treatment of this Court's decision in *Federal Baseball Club* v. *National League of Professional Baseball Clubs*, 259 U. S. 200. In that case this Court had held for reasons given that professional baseball was not covered by the antitrust acts. Congress was asked through the years to change the law in this respect but declined to do so. In *Toolson* v. *New York Yankees, Inc.*, 346 U. S. 356, we followed the holding of that case without re-examination of the underlying issues "so far as that decision determines that Congress had no intention of including the business of baseball within the scope of the federal antitrust laws." Later we were asked to extend the *Federal Baseball* case and to hold that the business of boxing could not without congressional action be brought within the antitrust laws. We emphatically declined to do so in *United States* v. *International Boxing Club*, 348 U. S. 236, nor did we overrule *Toolson* in that case, despite strong arguments that the reasoning of the Court in the first baseball case was equally applicable to the business of boxing. We said about the proposed exemption of boxing from the antitrust laws that "[t]heir remedy, if they are entitled to one, lies in further resort to Congress."[22] That case and that statement fit this

[22] 348 U. S., at 244.

case precisely. In fact, as we are about to explain, a far more meaningful distinction can be made between embezzlement and extortion for purposes of this case than it was possible to make between baseball and boxing for purposes of that case, as MR. JUSTICE FRANKFURTER's dissenting opinion in that case demonstrates.

If the Government wants to prosecute the local crime of embezzlement, ostensibly because of "tax evasion," it seems clear to us that it should take its request to Congress which has power to pass on it and which has, to date, refused to do what the Government asks us to do in this case.

IV.

Our Brethren advance as a reason for overruling *Wilcox* the 1952 decision in *Rutkin* v. *United States*, which was decided three years before we denied certiorari in the *Dix* case. They say that "the reasoning used in *Rutkin* leads us inescapably to the conclusion that *Wilcox* was thoroughly devitalized." This follows, to some extent, the statement in the Government's brief that "*Wilcox* and *Rutkin* cannot be reconciled on the basis of asserted technical differences between the extortionist and the embezzler. . . . The proper course, we submit . . . is to recognize that the *Wilcox* rationale was rejected in *Rutkin*, is unsound, and can no longer be regarded as having vitality. Embezzled funds represent taxable gains." [23]

There is no doubt that some of the reasoning in the *Rutkin* opinion rejected some of the reasoning in the *Wilcox* opinion. But this is true only with respect to the broad general standards formulated in the two cases, and such standards of course cannot be accepted as universal panaceas to be mechanically applied to solve all the con-

[23] Brief for the United States, pp. 32-33.

crete problems in cases like these. Moreover, the *Rutkin* opinion expressly purported not to overrule *Wilcox* and specifically said that *Wilcox* was still to govern cases fitting its facts, clearly meaning embezzlement cases.[1] And the Government had not asked in *Rutkin* that *Wilcox* be overruled. Its argument was that *Wilcox* was "inapplicable" to the facts in the *Rutkin* record. The Government's brief went on to emphasize that the record in *Wilcox* showed only the bare receipt of money wholly belonging to another, while Rutkin had received the money "as a result of a bilateral agreement" and, as the Court of Appeals had pointed out, "with a semblance of a *bona fide* claim of right", a conclusion fully substantiated by the testimony of both the petitioner and the Government witness Reinfeld."[2] The Government went on to distinguish *Rutkin* further by pointing out that there was "not the slightest hint in the record" that Rutkin ever had an obligation to repay the funds he took.

After this Court was persuaded by the Government in *Rutkin* to accept its distinctions between *Rutkin* and *Wilcox*, it seems rather odd to have the Government now

[1] "We do not reach in this case the factual situation involved in *Commissioner* v. *Wilcox*, 327 U. S. 404. We limit that case to its facts." There embezzled funds were held not to constitute taxable income to the embezzler under § 22 (a). "The issue here is whether money extorted from a victim with his consent induced solely by harassing demands and threats of violence is included in the definition of gross income under § 22 (a)." 343 U. S., at 138.

[2] Brief for the United States in Opposition to Petition for Certiorari, *Rutkin* v. *United States*, 343 U. S. 130, pp. 13-14. The full sentence in the Court of Appeals opinion from which the Government quoted was: "So he [Rutkin] did receive the money 'with a semblance of a bona fide claim of right' as the embezzler had not in Commissioner of Internal Revenue v. Wilcox, supra, 327 U. S. at page 408, 66 S. Ct. at page 549." *United States* v. *Rutkin*, 189 F. 2d 431, 435.

contend that the two cases are irreconcilable. While we disagreed, we can understand why the majority in *Rutkin* drew the distinctions it did. Although the victim of either embezzlement or extortion ordinarily has a legal right to restitution, the extortion victim, like a blackmail victim, can in a sense be charged with complicity in bringing about the taxable event in that he knowingly surrendered the funds to the extortionist, sometimes in payment of an actual obligation. Unlike the victim of an ordinary theft, he generally knows who has taken the property from him and he consents to the taking though under duress; and unlike most victims of embezzlement, he is able to report the taking to law enforcement officers during the taxable year and his failure to do so might be considered a kind of continuing consent to the extortionist's dominion over the property. The longer he acquiesces the less likely it becomes that the extortion victim ever will demand restitution;[26] but once the victim of an embezzlement finds out that his property has been stolen, he most likely will immediately make efforts to get it back. Thus, although we still think *Rutkin* was wrongly decided for the reasons expressed in the dissenting opinion in that case, we can understand the argument for application of a sort of *caveat emptor* rule to persons who submit to blackmail or extortion, since it is far from certain that they will ever expose themselves by seeking repayment of what they paid out. The dis-

[26] This factual distinction was clearly emphasized in the Court's opinion in *Rutkin*: "[Rutkin] induced Reinfeld to consent to pay the money by creating a fear in Reinfeld that harm otherwise would come to him and to his family. Reinfeld thereupon delivered his own money to petitioner. Petitioner's control over the cash so received was such that, *in the absence of Reinfeld's unlikely repudiation of the transaction and demand for the money's return*, petitioner could enjoy its use as fully as though his title to it were unassailable." *Rutkin* v. *United States*, 343 U. S. 130, 136–137. (Emphasis supplied.)

tinctions between crimes like embezzlement and crimes like blackmail and extortion, therefore, are not merely technical, legalistic "attenuated subtleties" for purposes of this decision, but are differences based upon practicalities such as often underlie the distinctions that have been developed in our law.

In departing from both the *Wilcox* and *Rutkin* decisions today, our Brethren offer no persuasive reasons to prove that their judgment in overruling *Wilcox* is better than that of the Justices who decided that case. It contributes nothing new to the analysis of this problem to say repeatedly that the dishonest man must be subject to taxation just as the honest. As already said, Chief Justice Stone and the others sitting with him on the *Wilcox* Court fully accepted that general principle and we do still. Applying it here, we would say the embezzler should be treated just like the law-abiding, honest borrower who has obtained the owner's consent to his use of the money.[27] It

[27] The analogy between the borrower and the embezzler was lucidly analyzed by Judge Sibley in *McKnight* v. *Commissioner*, 127 F. 2d 572, 573–574.

The several cases relied on by the Court do not, in our judgment, justify imposing a tax upon embezzled money. *Corliss* v. *Bowers*, 281 U. S. 376, involved income accumulating in a trust fund belonging to the taxpayer and over which he retained control. *North American Oil Co.* v. *Burnet*, 286 U. S. 417; *United States* v. *Lewis*, 340 U. S. 590; and *Healy* v. *Commissioner*, 345 U. S. 278, were cases in which the taxpayer had asserted a bona fide, though mistaken, claim of right. In *Burnet*, the taxpayer not only had a bona fide claim to the money taxed, but there had been an adjudication that he was entitled to it, and there was only the tenuous possibility that a competing claimant might later upset that adjudication. The *Lewis* and *Healy* cases involved a tax on payments made and received as a result of mutual mistake, and it was held that the administration of the tax laws on an annual basis need not be upset for the convenience of those who caused the mistaken payments to be made and reported as income. By contrast, the victims do not cause

would be unthinkable to tax the borrower on his "gain" of the borrowed funds and thereby substantially impair the lender's chance of ever recovering the debt. The injury that the Government would inflict on the lender by making the borrower less able to repay the loan surely would not be adequately compensated by telling the lender that he can take a tax deduction for the loss, and it is equally small comfort to the embezzlement victim for the Government, after taking part of his property as a tax on the embezzler, to tell the victim that he can take a deduction for his loss if he has any income against which to offset the deduction. There is, of course, one outstanding distinction between a borrower and an embezzler, and that is that the embezzler uses the funds without the owner's consent. This distinction can be of no importance for purposes of taxability of the funds, however, because as a matter of common sense it suggests that there is, if anything, less reason to tax the embezzler than the borrower. But if this distinction is to be the reason why the embezzlement must be taxed just as "the gains of the honest laborer," then the use of this slogan in this case is laid bare as no more than a means of imposing a second punishment for the crime of embezzlement without regard to revenue considerations, the effect on the rightful owner, or the proper role of this Court when asked to overrule a criminal statutory precedent. The double jeopardy implications would seem obvious.[2]

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embezzlements, and the Government is not misled or inconvenienced under *Wilcox* because the embezzler is always fully aware that the embezzled funds are not rightfully his and presumably will not report otherwise.

[2] See the dissenting opinion in *Bartkus* v. *Illinois*, 359 U. S. 121, 150. It is interesting to note that on July 22, 1959, shortly after the *Bartkus* decision, Illinois, in order to avoid the danger of prosecuting men in both state and federal courts for the same crime, passed a statute making conviction or acquittal in a federal prosecution a

aid discussion of the serious inadvisability for other reasons of thus injecting the Federal Government into local law enforcement can be found in the dissenting opinion in *Rutkin*.

We regret very much that it seems to be implied that the writer of the *Rutkin* opinion and those who agreed to it intended to overrule *Wilcox* when it is manifest that the language the Court used in *Rutkin* was meant to leave precisely the opposite impression. We are sure that our Brethren at that time did not intend to mislead the public, and it would be hard to imagine why they said what they did in the *Rutkin* opinion had they not specifically considered and rejected the possibility of overruling *Wilcox* then and there. We think it is unjustifiable to say nine years after *Rutkin* that it "devitalized" or "repudiated" the *Wilcox* holding when the *Rutkin* opinion said explicitly that *Wilcox* is still the rule as to embezzlement. Congress has seen fit to let both decisions stand, and we think the present Court should do the same.

V.

Even if we were to join with our Brethren in accepting the Government's present contention that *Wilcox* and *Rutkin* cannot both stand, we would disagree as to which of the two decisions should now be repudiated. This is true not only because we would feel less inhibition about narrowing rather than broadening the reach of a previously construed criminal statute. Regardless of such considerations, our conviction that the *Rutkin* case was wrongly decided in this Court remains undiminished and has been further substantiated by the subsequent events

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defense to a state prosecution for the same criminal act. Illinois Laws, 1959, p. 1893, § 1; 38 Ill. Ann. Stat. § 601.1. Thus, while Illinois is moving away from such double prosecutions, this Court is moving even further than *Bartkus* in the direction of authorizing such prosecutions.

in that controversy, which show all the more clearly the deplorable consequences that can result when federal courts subject people who violate state criminal laws to a double or treble prosecution for the state crime under the guise of attempted enforcement of federal tax laws.[29]

For the foregoing reasons, as well as the reasons stated in MR. JUSTICE WHITTAKER'S opinion, we would reaffirm our holding in *Commissioner* v. *Wilcox*, reverse this judgment and direct that the case be dismissed.

[29] The subsequent history of the Rutkin-Reinfeld controversy can, in part, be read in *United States* v. *Rutkin*, 208 F. 2d 647, especially Judge Kalodner's dissenting opinion, at 655; *United States* v. *Rutkin*, 212 F. 2d 641, especially at 644; and *Rutkin* v. *Reinfeld*, 122 F. Supp. 265, reversed, 229 F. 2d 248.

SUPREME COURT OF THE UNITED STATES

No. 63.—October Term, 1960.

Eugene C. James, Petitioner, v. United States.	On Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit.

[May 15, 1961.]

Mr. Justice Clark, concurring in part and dissenting in part as to the opinion of The Chief Justice.

Although I join in the specific overruling of *Commissioner* v. *Wilcox*, 327 U. S. 404 (1946), in The Chief Justice's opinion, I would affirm this conviction on either of two grounds. I believe that the Court not only devitalized *Wilcox*, by limiting it to its facts in *Rutkin* v. *United States*, 343 U. S. 130 (1952), but that in effect the Court overruled that case *sub silentio* in *Commissioner* v. *Glenshaw Glass Co.*, 348 U. S. 426 (1955). Even if that not be true, in my view the proof shows conclusively that petitioner, in willfully failing to correctly report his income, placed no bona fide reliance on *Wilcox*.

SUPREME COURT OF THE UNITED STATES

No. 63.—October Term, 1960.

Eugene C. James, Petitioner, v. United States.	On Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit.

[May 15, 1961.]

Mr. Justice Harlan, whom Mr. Justice Frankfurter joins, concurring in part and dissenting in part as to the opinion of The Chief Justice.

I fully agree with so much of The Chief Justice's opinion as dispatches *Wilcox* to a final demise. But as to the disposition of this case, I think that rather than an outright reversal which his opinion proposes, the reversal should be for a new trial.

I share the view that it would be inequitable to sustain this conviction when by virtue of the *Rutkin-Wilcox* dilemma it might reasonably have been thought by one in petitioner's position that no tax was due in respect of embezzled moneys. For as is pointed out, *Rutkin* did not expressly overrule *Wilcox*, but instead merely confined it "to its facts." Having now concluded that *Wilcox* was wrongly decided originally, the problem in this case thus becomes one of how to overrule *Wilcox* "in a manner that will not prejudice those who might have relied on it." *Ante*, p. —.

It is argued, in reliance on *Spies* v. *United States*, 317 U. S. 492, and *Holland* v. *United States*, 348 U. S. 121, that so long as *Wilcox* remained on the books the element of "willfulness" required in prosecutions of this kind[1] "could not be proven," and hence, that the conviction of

[1] The relevant statutes are set forth in footnotes 1-5 of The Chief Justice's opinion *Ante*, pp. —, —.

this petitioner fails without more. This would mean, I take it, that no future prosecution or past conviction involving tax derelictions of this nature, occurring during the *Wilcox* period, may be brought or allowed to stand. I cannot agree to such a disposition, which, in my view, is warranted by neither principle nor authority and would carry mischievous implications for the future.

The *Spies* and *Holland* cases, which are said to support outright reversal, stand for no more than that where, as here, a criminal tax statute makes "willfulness" an element of the offense, the Government must prove "an evil motive and want of justification in view of all the circumstances" on the part of the defendant, in failing to do what was required of him. While I agree that in the present case this made germane on the issue of willfulness the petitioner's reliance or nonreliance on the continued vitality of the *Wilcox* doctrine,[1] I can find nothing in *Spies* or *Holland* which justifies the view that the mere existence of *Wilcox* suffices alone to vitiate petitioner's conviction *as a matter of law*. If, as appears to have been the case, there was erroneous failure to take that factor into account at the trial on the issue of willfulness, the most that should happen is that petitioner should be given a new trial. This indeed is what *Spies* and *Holland* affirmatively indicate as the right solution of the problem this case presents. In *Spies*, it was said (at pp. 499–500):

> ". . . By way of illustration, and not by way of limitation, we would think affirmative willful attempt

[1] Compare American Law Institute, Model Penal Code, tentative draft No. 4, § 2.04:

> Ignorance or mistake as to a matter of fact or law is a defense if
>
> (a) the ignorance or mistake negatives the purpose, knowledge, belief, recklessness or negligence required to establish a material element of the offense.

may be inferred from conduct such as keeping a double set of books, making false entries or alterations, or false invoices or documents, destruction of books or records, concealment of assets or covering up sources of income, handling of one's affairs to avoid making the records usual in transactions of the kind, and any conduct, the likely effect of which would be to mislead or to conceal. If the tax-evasion motive plays any part in such conduct the offense may be made out even though the conduct may also serve other purposes, such as concealment of other crime.

"In this case there are several items of evidence apart from the default in filing the return and paying the tax which the Government claims will support an inference of willful attempt to evade or defeat the tax. These go to establish that petitioner insisted that certain income be paid to him in cash, transferred it to his own bank by armored car, deposited it, not in his own name but in the names of others of his family, and kept inadequate and misleading records. Petitioner claims other motives animated him in these matters. We intimate no opinion. Such inferences are for the jury. If on proper submission the jury found these acts, taken togther with willful failure to file a return and willful failure to pay the tax, to constitute a willful attempt to evade or defeat the tax, we would consider conviction of a felony sustainable." To the same effect, see *Holland*, *supra*, at p. 139.

In the case at hand, the evidence of devious financial arrangements might well support the inference that petitioner's purpose was not only to commit the embezzlement but also to secrete and immunize his gains from what he considered to be his tax liabilities in respect of those gains. The District Court, as the trier of the facts (there having been no jury), found that petitioner's acts

were "willful and were done in a knowing and conscious attempt to evade and defeat" his tax obligations. But since it does not appear that petitioner's possible reliance on the *Wilcox* doctrine was considered below, *Spies* and *Holland* makes it appropriate for us to send the case back for a new trial. They do not support foreclosing the Government from even undertaking to prove that the petitioner's conduct was "willful" in this respect.

An outright reversal is equally unsound on principle. I take it that our decisions in the tax and any other field for that matter *relate back* to the actual transactions with which they are concerned, and that that is only the normal concomitant of the fact that we do not sit as an administrative agency making rulings for the future, but rather adjudicate actual controversies as to rights and liabilities under the laws of the United States. There can be, I think, two justifications for barring a prosecution of this petitioner in the unusual circumstances presented here: (1) that by reason of *Rutkin* having formally left intact the *Wilcox* doctrine, petitioner did not have due warning of his possible criminal liability; and (2) that the Court, in making new "law" in *Rutkin* should, like the legislature, not impose criminal liability *ex post facto*.

As to the first consideration, where the defendant is charged in a case like this with having "willfully" violated the law, I believe that both reason and authority require no more than that the trier of fact be instructed that it must take into account in determining the defendant's "evil motive and want of justification," *Spies* v. *United States*, 317 U. S., at 498, his possible reliance on *Wilcox*, which not until now has this Court explicitly stated was wrongly decided. As far as fairness to this petitioner is concerned, I do not see why that is not amply accorded by the disposition which *Spies* itself exemplifies.

See p. —, *supra*. On the other hand, if the trier of fact, properly instructed, finds that the petitioner did not act in bona fide reliance on *Wilcox*, but deliberately refused to report income and pay taxes thereon knowing of his obligation to do so and not relying on any exception in the circumstances, I do not see why even the strictest definition of the element of "willfulness" would not have been satisfied. Willfulness goes to motive, and the quality of a particular defendant's motive would not seem to be affected by the fact that another taxpayer similarly situated had a different motive.

An altogether analogous situation was presented in *Murdock* v. *United States*, 290 U. S. 389. In that case the respondent had been convicted of willfully failing to supply information to the Bureau of Internal Revenue in that he relied on the possibility of state prosecution as justifying his invoking the federal privilege against self-incrimination. The Court said in that case:

> ". . . He whose conduct is defined as criminal is one who '*willfully*' fails to pay the tax, make the return, to keep the required records, or to supply the needed information. Congress did not intend that a person, by reason of a bona fide misunderstanding as to his liability for the tax, . . . should become a criminal by his mere failure to measure up to the prescribed standards of conduct. . . .
>
> "It follows that the respondent was entitled to the charge he requested with respect to his good faith and actual belief. Not until this Court pronounced judgment in United States v. Murdock, 284 U. S. 141, had it been definitely settled that one under examination in a federal tribunal could not refuse to answer on account of probable incrimination under state law. The question was involved, but not decided, in Ballman v. Fagin, 200 U. S. 186, 195, and

specifically reserved in Vajtauer v. Comm'r of Immigration, 273 U. S. 103, 113. The trial court could not, therefore, properly tell the jury the defendant's assertion of the privilege was so unreasonable and ill-founded as to exhibit bad faith and establish willful wrongdoing. This was the effect of the instructions given. We think the Circuit Court of Appeals correctly upheld *the respondent's right to have the question of absence of evil motive submitted to the jury.* . . ." (Emphasis supplied.)

It would seem that precisely the same disposition is in order in this case. Nor do I think that distinctions in terms of the nature of the defendant's legal misapprehension, its degree, its justifiability, or its source are either warranted or would be manageable as a basis for deciding future cases.

Coming now to the other possible rationale for barring the prosecution of this petitioner, it might be argued that petitioner at the time he failed to make his return was not under any misapprehension as to the law, but indeed that at the time and under the decisions of this Court his view of the law was entirely correct. The argument not only seems to beg the question, but raises further questions as to the civil liability of one situated in the circumstances of this petitioner. Petitioner's obligation here derived not from the decisions of this or any other court, but from the Act of Congress imposing the tax. It is hard to see what further point is being made, once it is conceded that petitioner, if he was misled by the decisions of this Court, is entitled to plead in defense that misconception. Only in the most metaphorical sense has the law changed: the decisions of this Court have changed, and the decisions of a court interpreting the acts of a legislature have never been subject to the same limitations which are imposed on legislatures themselves, United States Constitution,

Art. I, §§ 9, 10, forbidding them to make any *ex post facto* law[3] and in the case of States to impair the obligations of a contract. *Ross* v. *Oregon*, 227 U. S. 150; *New Orleans Water Works Co.* v. *Louisiana Sugar Refining Co.*, 125 U. S. 18.

The proper disposition of this case, in my view, is to treat as plain error, Fed. Rules Crim. Proc. 52 (b), the failure of the trial court as trier of fact to consider whatever misapprehension may have existed in the mind of the petitioner as to the applicable law, in determining whether the Government had proved that petitioner's conduct had been willful as required by the statute. On that basis I would send the case back for a new trial.

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[3] Aside from problems of warning and specific intent, the policy of the prohibition against *ex post facto* legislation would seem to rest on the apprehension that the legislature, in imposing penalties on past conduct, even though the conduct could properly have been made criminal and even though the defendant who engaged in that conduct in the past believed he was doing wrong (as for instance, when the penalty is increased retroactively on an existing crime), may be acting with a purpose not to prevent dangerous conduct generally but to impose by legislation a penalty against specific persons or class of persons. That this policy is inapplicable to decisions of the courts seems obvious: their opportunity for discrimination is more limited than the legislature's, in that they can only act in construing existing law in actual litigation. Given the divergent pulls of flexibility and precedent in our case law system, it is disquieting to think what perplexities and what subtleties of distinction would be created in applying this policy, which so properly limits legislative action, to the decisions of the courts.

SUPREME COURT OF THE UNITED STATES

No. 63.—October Term, 1960.

Eugene C. James, Petitioner, v. United States. | On Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit.

[May 15, 1961.]

Mr. Justice Whittaker, whom Mr. Justice Black and Mr. Justice Douglas join, concurring in part and dissenting in part.

The starting point of any inquiry as to what constitutes taxable income must be the Sixteenth Amendment, which grants Congress the power "to lay and collect taxes on incomes, from whatever course derived . . . ." It has long been settled that Congress' broad statutory definitions of taxable income were intended "to use the full measure of [the Sixteenth Amendment's] taxing power." *Helvering* v. *Clifford*, 309 U. S. 331, 334; *Douglas* v. *Willcuts*, 296 U. S. 1, 9. Equally well settled is the principle that the Sixteenth Amendment "is to be taken as written and is not to be extended beyond the meaning clearly indicated by the language used." *Edwards* v. *Cuba Railroad*, 268 U. S. 628, 631.[1] The language of the Sixteenth Amendment, as well as our prior controlling decisions, compel me to conclude that the question now before us—whether an embezzler receives taxable income at the time of his unlawful taking—must be answered negatively.

[1] "A proper regard for its genesis, as well as its very clear language, requires also that [the Sixteenth] Amendment shall not be extended by loose construction . . . . Congress cannot by any definition [of income] it may adopt conclude the matter, since it cannot by legislation alter the Constitution, from which alone it derives its power to legislate, and within whose limitations alone that power can be lawfully exercised." *Eisner* v. *Macomber*, 252 U. S. 189, 206.

Since the prevailing opinion reaches an opposite conclusion, I must respectfully dissent from that holding, although I concur in the Court's judgment reversing petitioner's conviction. I am convinced that *Commissioner* v. *Wilcox*, 327 U. S. 404, which is today overruled, was correctly decided on the basis of every controlling principle used in defining taxable income since the Sixteenth Amendment's adoption.

The CHIEF JUSTICE's opinion, although it correctly recites *Wilcox's* holding that "embezzled money does not constitute taxable income to the embezzler *in the year of the embezzlement*" (emphasis added), fails to explain or to answer the true basis of that holding. *Wilcox* did not hold that embezzled funds may never constitute taxable income to the embezzler. To the contrary, it expressly recognized that an embezzler may realize a taxable gain to the full extent of the amount taken, if and when it ever becomes *his*. The applicable test of taxable income, *i. e.*, the "presence of a claim of right to the alleged gain," of which *Wilcox* spoke, was but a correlative statement of the factor upon which the decision placed its whole emphasis throughout, namely, the "absence of a definite, unconditional obligation to repay or return [the money]." 327 U. S., at 408. In holding that this test was not met at the time of the embezzlement, the *Wilcox* opinion repeatedly stressed that the embezzler had no "bona fide legal or equitable claim" to the embezzled funds, *ibid.*; that the victim never "condoned or forgave the taking of the money and still holds him liable to restore it," *id.*, at 406; and that the "debtor-creditor relationship was definite and unconditional." *Id.*, at 409. These statements all express the same basic fact—the fact which is emphasized most strongly in the opinion's conclusion explaining why the embezzler had not yet received taxable income: "Sanctioning a tax in the circumstances before us would serve only to give the United States an unjustified prefer-

ence as to part of the money which *rightfully and completely belongs to the taxpayer's employer.*" *Id.*, at 410. (Emphasis added.)

However, *Wilcox* plainly stated that "if the unconditional indebtedness is cancelled or retired, taxable income may adhere, under certain circumstances, to the taxpayer." 327 U. S., at 408. More specifically, it recognized that had the embezzler's victim "condoned or forgiven any part of the [indebtedness]; the [embezzler] might have been subject to tax liability to that extent," *id.*, at 410; *i. e.*, in the tax year of such forgiveness.

These statements reflect an understanding of, and regard for, substantive tax law concepts solidly entrenched in our prior decisions. Since our landmark case of *United States* v. *Kirby Lumber Co.*, 284 U. S. 1, it has been settled that upon a discharge of indebtedness by an event other than full repayment, the debtor realizes a taxable gain in the year of discharge to the extent of the indebtedness thus extinguished. Such gains are commonly referred to as ones realized through "bargain cancellations" of indebtedness, and it was in this area, and indeed, in *Kirby Lumber Co.* itself, that the "accession" theory or "economic gain" concept of taxable income, upon which the CHIEF JUSTICE's opinion today mistakenly relies, found its genesis. In that case, the taxpayer, a corporation, had reduced a portion of its debt, with a corresponding gain in assets, by purchasing its bonds in the open market at considerably less than their issue price. Mr. Justice Holmes, who wrote the Court's opinion, found it unnecessary to state the elementary principle that, so long as the bonds remained a fully enforceable debt obligation of the taxpayer, there could be no taxable gain. However, when the taxpayer retired the debt by purchasing the bonds for less than their face value, it "made a clear [taxable] gain" and "realized within the year an accession to income" in the amount of its bargain. 284 U. S., at 3.

This doctrine has since been reaffirmed and strengthened by us, see, *e. g.*, *Helvering* v. *American Chicle Co.*, 291 U. S. 426; *Commissioner* v. *Jacobson*, 336 U. S. 28, and by the lower federal courts in numerous decisions involving a variety of "bargain cancellations" of indebtedness, as by a creditor's release condoning or forgiving the indebtedness in whole or in part,[2] or by the running of a Statute of Limitations barring the legal enforceability of the obligation.[3] In none of these cases has it been suggested that a taxable gain might be realized by the debtor at any time *prior* to the effective date of discharge, and as *Wilcox* recognized, there is no rational basis on which to justify such a rule where the debt arises through embezzlement.

An embezzler, like a common thief, acquires not a semblance of right, title, or interest in his plunder, and whether he spends it or not, he is indebted to his victim in the full amount taken as surely as if he had left a signed promissory note at the scene of the crime. Of no consequence from any standpoint is the absence of such formalities as (in the words of the prevailing opinion) "a consensual recognition, express or implied, of an obligation to repay." The law readily implies whatever "consensual recognition" is needed for the rightful owner to assert an immediately ripe and enforceable obligation of repayment against the wrongful taker. These principles are not "attenuated subtleties" but are among the clearest and most easily applied rules of our law. They exist to

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[2] See, *e. g.*, *Spear Box Co.* v. *Commissioner*, 182 F. 2d 844 (C. A. 2d Cir.); *Helvering* v. *Jane Holding Corp.*, 109 F. 2d 933 (C. A. 8th Cir.); *Pacific Magnesium, Inc.*, v. *Westover*, 86 F. Supp. 644 (D. C. S. D. Cal.).

[3] See, *e. g.*, *Schweppe* v. *Commissioner*, 168 F. 2d 284 (C. A. 9th Cir.); *North American Coal Corp.* v. *Commissioner*, 97 F. 2d 325 (C. A. 6th Cir.); *Securities Co.* v. *United States*, 85 F. Supp. 532 (D. C. S. D. N. Y.).

protect the rights of the innocent victim, and we should accord them full recognition and respect.

The fact that an embezzler's victim may have less chance of success than other creditors in seeking repayment from his debtor is not a valid reason for us further to diminish his prospects by adopting a rule that would allow the Commissioner of Internal Revenue to assert and enforce a prior federal tax lien against that which "rightfully and completely belongs" to the victim. *Commissioner* v. *Wilcox, supra*, at 410. The CHIEF JUSTICE's opinion quite understandably expresses much concern for "honest taxpayers," but it attempts neither to deny nor justify the manifest injury that its holding will inflict on those honest taxpayers, victimized by embezzlers, who will find their claims for recovery subordinated to federal tax liens. Statutory provisions, by which we are bound, clearly and unequivocally accord priority to federal tax liens over the claims of others, including "judgment creditors."[4]

However, if it later happens that the debtor-creditor relationship between the embezzler and his victim is discharged by something other than full repayment, such as

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[4] 26 U. S. C. §§ 6321–6323, 6331; Bankruptcy Act, § 64 (a), 11 U. S. C. § 104 (a). Moreover, R. S. § 3466 (1875), now codified in 31 U. S. C. § 191, pertaining to state insolvency proceedings against debtors, commands that "the debts due to the United States shall be first satisfied." We long ago established that the term "debts" in this statute includes delinquent federal taxes. *Price* v. *United States*, 269 U. S. 492, 499–500. And even though the tax claim of the Government may be only a general lien, with notice thereof not yet filed in the proper local office pursuant to 26 U. S. C. § 6323, we have held that it must be accorded priority over the claims of all prior general lienholders, under R. S. § 3466, 31 U. S. C. § 191. *United States* v. *City of New Britain*, 347 U. S. 81, 84–85; *United States* v. *Gilbert Associates*, 345 U. S. 361, 366; *United States* v. *Texas*, 314 U. S. 480, 488. See Mertens, Law of Federal Income Taxation, § 12.103, note 67; *id.*, §§ 54.10–54.56.

by the running of a Statute of Limitations against the victim's claim, or by a release given for less than the full amount owed, the embezzler at that time, but not before, will have made a clear taxable gain and realized "an accession to income" which he will be required under full penalty of the law to report in his federal income tax return for that year. No honest taxpayer could be harmed by this rule.

The inherent soundness of this rule could not be more clearly demonstrated than as applied to the facts of the case before us. Petitioner, a labor union official, concededly embezzled sums totaling more than $738,000 from the union's funds, over a period extending from 1951 to 1954. When the shortages were discovered in 1956, the union at once filed civil actions against petitioner to compel repayment. For reasons which need not be detailed here, petitioner effected a settlement agreement with the union on July 30, 1958, whereby, in exchange for releases fully discharging his indebtedness, he repaid to the union the sum of $13,568.50. Accordingly, at least so far as the present record discloses, petitioner clearly realized a taxable gain in the year the releases were executed, to the extent of the difference between the amount taken and the sum restored. However, the Government brought the present action against him, not for his failure to report this gain in his 1958 return, but for his failure to report that he had incurred "income" from—actually indebtedness to—the union in each of the years 1951 through 1954. It is true that the Government brought a criminal evasion prosecution rather than a civil deficiency proceeding against petitioner, but this can in no way alter the substantive tax law rules which alone are determinative of liability in either case.

There can be no doubt that until the releases were executed in 1958, petitioner and the union stood in an absolute and unconditional debtor-creditor relationship, and

under all of our relevant decisions, no taxable event could have occurred until the indebtedness was discharged for less than full repayment. Application of the normal rule in such cases will not hinder the efficient and orderly administration of the tax laws, any more than it does in other situations involving "bargain cancellations" of indebtedness. More importantly, it will enhance the creditor's position by assuring that prior federal tax liens will not attach to the subject of the debt when he seeks to recover it.

Notwithstanding all of this, the CHIEF JUSTICE's opinion concludes that there is no difference between embezzled funds and "gains" from other "illegal sources," and it points to the fact that Congress, in its 1916 amendment of the 1913 Income Tax Act, omitted the word "lawful" in describing businesses whose income was to be taxed. The opinion then cites *United States* v. *Sullivan*, 274 U. S. 259, in which it was held that, under the amended statute, gains from illicit traffic in liquor must be reported in gross income, since there is no "reason why the fact that a business is unlawful should exempt it from paying the taxes that *if lawful* it would have to pay." *Id.*, at 263. (Emphasis added.) That theory has been the primary basis for taxing "unlawful gains of many kinds" which the prevailing opinion today recites, such as black market profits, gambling proceeds, money derived from the sale of unlawful insurance policies, etc.[1] For, even *if lawful*, the gains from such activities would clearly not be exempted from taxation. However, as applied to embezzled funds, the holding in *Sullivan* contradicts, rather than supports, the Court's conclusion today. Obvi-

[1] See cases cited in *Rutkin* v. *United States*, 343 U. S. 130, 137, note 8. See also *United States* v. *Brunwitz*, 219 F. 2d 59 (C. A. 2d Cir.); *Steinberg* v. *United States*, 14 F. 2d 564 (C. A. 2d Cir.); *Barker* v. *United States*, 26 F. Supp. 1004 (Ct. Cl.); *Silberman* v. *Commissioner*, 44 B. T. A. 600.

ously, embezzlement could never become "lawful" and still retain its character. If "lawful," it would constitute nothing more than a loan, or possibly a gift, to the "embezzler," neither of which would produce a taxable gain to him.

There is still another obvious and important distinction between embezzlement and the varieties of illegal activity listed by the prevailing opinion—one which clearly calls for a different tax treatment. Black marketeering, gambling, bribery, graft and like activities generally give rise to no legally enforceable right of restitution—to no debtor-creditor relationship which the law will recognize.[6] Condemned either by statute or public policy, or both, such transactions are void *ab initio*. Since any consideration which may have passed is not legally recoverable, its recipient has realized a taxable gain, an "accession to income," as clearly as if his "indebtedness" had been discharged by a full release or by the running of a Statute of Limitations. As we have already shown at length, quite the opposite is true when an embezzlement occurs; for then the victim acquires an immediately ripe and enforceable claim to repayment, and the embezzler assumes a legal debt equal to his acquisition.

To reach the result that it does today, the CHIEF JUSTICE's opinion constructs the following theory for defining taxable income:

> "When a taxpayer acquires earnings, lawfully or unlawfully, without the consensual recognition, express or implied, of an obligation to repay and without restriction as to their disposition, he has

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[6] Restatement, Contracts, § 598; 6 Corbin, Contracts, §§ 1373 *et seq.* (1951). That the rule applies even as to "unlawful insurance policies" is undoubted. Patterson, Essentials of Insurance Law (2d ed. 1957), § 43, at 186.

received income which he is required to return, even though it may still be claimed that he is not entitled to retain the money, and even though he may still be adjudged liable to restore its equivalent.' *North American Oil* v. *Burnet, supra*, at p. 424. In such case, the taxpayer has 'actual command over the property taxed—the actual benefit for which the tax is paid.' *Corliss* v. *Bowers, supra*. This standard brings wrongful appropriations within the broad sweep of 'gross income'; it excludes loans. When a law-abiding taxpayer mistakenly receives income in one year, which receipt is assailed and found to be invalid in a subsequent year, the taxpayer must nonetheless report the amount as 'gross income' in the year received. *United States* v. *Lewis, supra*; *Healy* v. *Commissioner, supra*."

This novel formula finds no support in our prior decisions, least of all in those which are cited. *Corliss* v. *Bowers*, 281 U. S. 376, involved nothing more than an *inter vivos* trust created by the taxpayer to pay the income to his wife. Since he had reserved the power to alter or abolish the trust at will, its income was taxable to him under the express provisions of § 219 (g), (h) of the Revenue Act of 1924. *North American Oil* v. *Burnet*, 286 U. S. 417, is the case which introduced the principle since used to facilitate uniformity and certainty in annual tax accounting procedure, *i. e.*, that a taxpayer must report in gross income, in the year in which received, money or property acquired under a "claim of right"—a colorable claim of the right to *exclusive possession* of the money or property. Thus, in its complete form, the sentence in *North American Oil* from which the above-quoted fragment was extracted reads: "If a taxpayer receives *earnings under a claim of right* and without restriction as to its [*sic*] disposition, he has received

income which he is required to return, even though it may still be claimed that he is not entitled to retain the money, and even though he may still be adjudged liable to restore its equivalent." *Id.*, at 424. (Emphasis added.) But embezzled funds, like stolen property generally, are not "earnings" in any sense and are held without a vestige of a colorable claim of right; they constitute the principal of a debt. Of no significance whatever is the formality of "consensual recognition, express or implied" of an obligation to repay. By substituting this meaningless abstraction in place of the omitted portion of the *North American Oil* test of *when* a receipt constitutes taxable income, the prevailing opinion today goes far beyond overruling *Wilcox*—it reduces a substantial body of tax law into uncertainty and confusion. The above-cited case of *United States* v. *Lewis*, 340 U. S. 590, decided 19 years after *North American Oil*, demonstrates the truth of this. For there we said:

> "The 'claim of right' interpretation of the tax laws has long been used to give finality to [the accounting] period, and is now deeply rooted in the federal tax system. . . . We see no reason why the Court should depart from this well-settled interpretation merely because it results in an advantage or disadvantage to a taxpayer." 340 U. S. at 592.

The same principle was reiterated and applied in *Healy* v. *Commissioner*, 345 U. S. 278.

The supposed conflict between *Wilcox* and *Rutkin*, upon which the CHIEF JUSTICE's opinion seeks to justify its repudiation of *Wilcox*,[1] has been adequately treated in

[1] I cannot agree with the CHIEF JUSTICE's assertion that *Wilcox* has been "thoroughly devitalized" by *Rutkin*. See, *e. g.*, the recent case of *United States* v. *Peelle*, 159 F. Supp. 45 (D. C. E. D. N. Y., 1958). There the Government sought to enforce liens for federal income taxes claimed to be due on items of "income" aggregating $678,461.22.

the opinion of MR. JUSTICE BLACK, and I agree with him that those cases were fully intended to be, and are, reconcilable, both on their controlling facts and applicable law. If the unnecessarily broad language used in the *Rutkin* opinion has misled any of the lower federal courts in their understanding of the principles underlying *Wilcox*, we should clarify their understanding at this time, and continue our adherence to "a prior doctrine more embracing in scope, intrinsically sounder, and verified by experience." *Helvering* v. *Hallock*, 309 U. S. 106, 119.

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which the taxpayer had embezzled from his corporate employer during the years 1945 through 1949. The items in question consisted of customers' payments intended for the corporation, and had been embezzled by the taxpayer and kept by him in secret bank accounts. In 1951 and 1952, he discharged his indebtedness by making full restitution of the embezzled funds to the corporation. The corporation, which used the accrual method of accounting, paid deficiencies which the Government determined in its 1945-1949 income tax returns, based on its accrued right to receive the embezzled customers' payments in those years. Not satisfied with this, the Government took the position that the payments were taxable *twice* during the same years—once to the corporation when it accrued the right to receive them, and again to the embezzler when he diverted them into the secret bank accounts. Had this effort at double taxation succeeded, the Government's combined tax claims would have been far in excess of the amount being taxed.

In rejecting the Government's argument that the embezzler received taxable income at the time of the embezzlements, the District Court relied wholly upon the decision which the Court today overrules, *Commissioner* v. *Wilcox*, *supra*.